

DOCKET SECTION
**OFFICIAL TRANSCRIPT OF PROCEEDINGS
BEFORE THE
POSTAL RATE COMMISSION**

In the Matter of:)
)
REQUEST OF THE UNITED STATES) Docket No. R2005-1
POSTAL SERVICE FOR A)
RECOMMENDED DECISION ON)
CHANGES IN RATES OF POSTAGE)
AND FEES FOR POSTAL SERVICES)

VOLUME #3

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OFFICE OF THE SECRETARY

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<u>WITNESSES:</u>	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	<u>VOIR DIRE</u>
Maura Robinson					
by Mr. Tidwell	333	--	--	--	--
by Ms. Hall	--	475	--	--	--
by Mr. Olson	--	485	--	--	--
Altaf Taufique					
by Mr. Tidwell	548	--	--	--	--
by Mr. Hart	--	729	--	--	--
by Mr. Morgan	--	735	--	--	--

<u>DOCUMENTS TRANSCRIBED INTO THE RECORD</u>	<u>PAGE</u>
Designation of corrected written cross-examination of USPS witness, Thomas E. Thress, USPS-T-7	276
Designation of corrected written cross-examination of USPS witness Maura Robinson, USPS-T-27	336
Response of USPS witness Robinson to POIR No. 2, Question 16	468
Designation of corrected written cross-examination of USPS witness Altaf H. Taufique, USPS-T-28	551
Response of Postal Service witness Taufique to POIR No. 2, Question 4	688
Response of witness Taufique to POIR No. 7, Question 14	757

E X H I B I T S

<u>EXHIBITS AND/OR TESTIMONY</u>	<u>IDENTIFIED</u>	<u>RECEIVED</u>
Corrected direct examination of USPS witness Thomas E. Thress, USPS-T-7; USPS-LR-K-63, K-64, K-65, and K-66	275	275
Designation of corrected written cross-examination of USPS witness, Thomas E. Thress, USPS-T-7	275	275
Corrected direct examination of USPS witness Maura Robinson, USPS-T-27	333	334
Designation of corrected written cross-examination of USPS witness Maura Robinson, USPS-T-27	335	335
Response of Postal Service witness Taufique to POIR No. 2, Question 4	550	668
Response of USPS witness Robinson to POIR No. 2, Question 16	467	467
Corrected direct examination of witness Altaf H. Taufique on behalf of USPS, USPS-T-28	548	549
Designation of corrected written cross-examination of USPS witness Altaf H. Taufique, USPS-T-28	550	550
Response of witness Taufique to POIR No. 7, Question 14	756	756
XEMMA-1	546	547
MMA-1	485	485

P R O C E E D I N G S

(9:33 a.m.)

CHAIRMAN OMAS: Good morning. Today, we continue hearings to receive the testimony of Postal Service witnesses in support of Docket No. R2005-1, the request for rates and fee changes.

Does anyone have a procedural matter to discuss before we continue?

(No response.)

CHAIRMAN OMAS: Three witnesses are scheduled to appear today. They are Witnesses Thress, Robinson, and Taufique. Our first scheduled witness this morning was to have been Thomas E. Thress. Ruling No. 35 excused Witness Thress from appearing.

Is the Postal Service prepared to enter his testimony and written cross-examination into the record at this time?

MR. KOETTING: Yes, Mr. Chairman. Eric Koetting for the Postal Service. At this point, pursuant to that ruling, we would move the direct testimony of Thomas E. Thress, which has been designated as USPS-T-7, into evidence for purposes of this proceeding.

Accompanying that and also sponsored by the witness are Category 2 Library References USPS-LR-K63, K64, K65, and K66. The Postal Service would move that the direct

1 testimony be entered into evidence and the associated
2 library references as well.

3 CHAIRMAN OMAS: Is there any objection?

4 (No response.)

5 CHAIRMAN OMAS: Hearing none, the testimony and
6 written cross-examination of Witness Thress is received into
7 evidence. Following our normal practice, I will direct the
8 reporter to transcribe the written cross-examination and to
9 include the certificates of authenticity into today's
10 transcripts at this point in the record. The testimony need
11 not be transcribed.

12 (The documents referred to,
13 previously identified as
14 Exhibit Nos. USPS-T-7 and
15 USPS-T-8 were received in
16 evidence.)

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POSTAL RATE COMMISSION
DOCKET NO. R2005-1
DECLARATION OF THOMAS THRESS

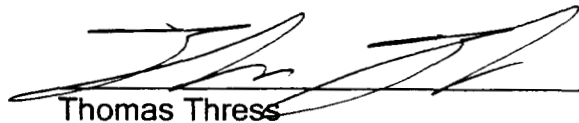
I hereby declare, under penalty of perjury, that:

The direct testimony of Thomas Thress on Behalf of the United States Postal Service, USPS-T-8 was prepared by me or under my direction; and

If I were to give this testimony before the Commission orally today, it would be the same.

I prepared the interrogatory responses which were filed under my name and which have been designated for inclusion in the record in this docket, and

If I were to respond to these interrogatories orally today, the responses would be the same.



Thomas Thress

DATE 6/24/05

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Request of the United States Postal
Service for a Recommended Decision on
Changes in Rates of Postage and Fees for
Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS THOMAS E. THRESS
(USPS-T-7)

Party

Interrogatories

Advo, Inc.

ABA&NAPM/USPS-T7-1, 6
GCA/USPS-T7-7, 9-11, 13-14

American Bankers Association and
National Association of Presort
Mailers

ABA&NAPM/USPS-T7-2a, f, 6, 7a-b, f-h, 8, 10-11

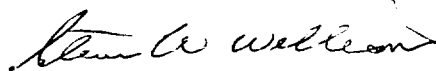
Greeting Card Association

ABA&NAPM/USPS-T7-2f
GCA/USPS-T7-1-2, 3b-d, 4-5, 8b-c, 9, 11, 12c,
15b

Valpak Direct Marketing Systems,
Inc. and Valpak Dealers' Association
Inc.

VP/USPS-T7-1-3, 4a-b, 5a-b

Respectfully submitted,



Steven W. Williams
Secretary

Interrogatory

VP/USPS-T7-4a

VP/USPS-T7-4b

VP/USPS-T7-5a

VP/USPS-T7-5b

Designating Parties

Valpak

Valpak

Valpak

Valpak

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS THOMAS E. THRESS (T-7)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
ABA&NAPM/USPS-T7-1	Advo
ABA&NAPM/USPS-T7-2a	ABA&NAPM
ABA&NAPM/USPS-T7-2f	ABA&NAPM, GCA
ABA&NAPM/USPS-T7-6	ABA&NAPM, Advo
ABA&NAPM/USPS-T7-7a	ABA&NAPM
ABA&NAPM/USPS-T7-7b	ABA&NAPM
ABA&NAPM/USPS-T7-7f	ABA&NAPM
ABA&NAPM/USPS-T7-7g	ABA&NAPM
ABA&NAPM/USPS-T7-7h	ABA&NAPM
ABA&NAPM/USPS-T7-8	ABA&NAPM
ABA&NAPM/USPS-T7-10	ABA&NAPM
ABA&NAPM/USPS-T7-11	ABA&NAPM
GCA/USPS-T7-1	GCA
GCA/USPS-T7-2	GCA
GCA/USPS-T7-3b	GCA
GCA/USPS-T7-3c	GCA
GCA/USPS-T7-3d	GCA
GCA/USPS-T7-4	GCA
GCA/USPS-T7-5	GCA
GCA/USPS-T7-7	Advo
GCA/USPS-T7-8b	GCA
GCA/USPS-T7-8c	GCA
GCA/USPS-T7-9	Advo, GCA
GCA/USPS-T7-10	Advo
GCA/USPS-T7-11	Advo, GCA
GCA/USPS-T7-12c	GCA
GCA/USPS-T7-13	Advo
GCA/USPS-T7-14	Advo
GCA/USPS-T7-15b	GCA
VP/USPS-T7-1	Valpak
VP/USPS-T7-2	Valpak
VP/USPS-T7-3	Valpak

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

ABA&NAPM/USPS-T7-1.

In your econometric specifications for addressing competing substitutes, you have claimed now for several consecutive rate increases that insufficient data exists to model competing substitutes in your FCLM demand equations as explicit variables, in particular that insufficient price data exists.

- a. Please confirm that high own price elasticities of demand tend to be associated with high cross price elasticities of demand, and vice versa.
- b. If sufficient high frequency volume data were available on competing substitutes, please confirm that cross price elasticities of demand could be calculated with respect to variations in postal rates and variations in the quantities demanded of competing substitutes.

RESPONSE

It is not clear to me to what specifically you are referring in your introductory sentence of this interrogatory.

a. Own-price elasticities of demand may be affected by a number of factors, including the number of substitutes, the closeness of these substitutes, other costs associated with the product, as well as the utility functions of the consumers of said product. In general, it is true that high cross-price elasticities of demand are often associated with high own-price elasticities of demand, although this need not be true.

b. It is hard to say with any degree of certainty what types of elasticities could be estimated given a particular data set without seeing the actual data of interest. As I noted above, it is not clear to me to what specific "high frequency volume data" you are referring. As such, I would be reluctant to offer any kind of definitive answer to your question here. As posited, however, I would say that it is not obvious to me how such information could be used to further our understanding of the demand for Postal products, which is, of course, the focus of my testimony.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

ABA&NAPM/USPS-T7-2.

Please refer to the following table.

Period	<u>R97-1</u>	<u>R2000-1</u>	<u>R2001-1</u>	<u>R2005-1</u>
First Class Mail:				
Single Piece Letters	-0.189	-0.262	-0.311	-0.175
Worksharing Discount	-0.164	-0.139	-0.027	-0.102
Subtotal	-0.353	-0.400	-0.338	-0.277
 Workshared Letters	 -0.289	 -0.251	 -0.071	 -0.329
Worksharing Discount	0.222	0.216	0.027	0.108
Subtotal	-0.067	-0.035	-0.044	-0.221

- a. Please confirm that the elasticities given in this table are correct.
- b. Please explain what specific factors might have caused the elasticities for Single Piece Letters to rise from 0.189 in R97-1 to 0.311 in R2001-1 and then to drop significantly to 0.175 in R2005-1.
- c. Please explain what specific factors might have caused the elasticities for Workshared Letters to drop from 0.289 in R97-1 to 0.071 in R2001-1 and then to more than quadruple to 0.329 in R2005-1.
- d. Please refer to the Worksharing Discount elasticities reported in the above table for the Single-Piece and the Workshared Letters. Please explain what specific factors might have caused these elasticities, in both cases, to exhibit a significant drop between R97-1 to R2001-1, but to quadruple between R2001-1 and R2005-1.
- e. Please confirm that the models used to estimate these elasticities over these four rate cases were different. Please explain whether these changing results are just the artifact of the data used and the variables included, or excluded, in the model.
- f. Please confirm that one possible way to compare these results is to run the same regression you have employed in your current testimony using the current data, variables, and model structure and run the regressions over 1983-1997, 1983-2000, 1983-2001, and 1998-2004. Please conduct the regressions for these time periods and provide the results.

RESPONSE:

- a. Confirmed.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF ABA&NAPM

b. Changes in demand elasticity estimates from one rate case to another may be the result of any of four possible factors: changes in the demand specification (e.g., replacing permanent income with employment in this case), changes in the time period over which the elasticities are estimated (e.g., the equations are estimated using data through 2005Q1 in this case), changes in the underlying data used in estimation (e.g., the Postal volume data used in this case has been restated from 2000 to the present to conform to Gregorian quarters, rather than Postal quarters), and changes in the econometric methodology by which the elasticities are estimated. This last factor is not especially relevant here, as the basic econometric methodology has not changed over the last several rate cases.

In order to accurately forecast mail volumes, it is important to be able to distinguish between cases where elasticities change because of specification changes – which represent improvements in one's estimates of the true elasticities – and cases where elasticities change simply because of the introduction of new data. Cases of this latter type may be indicative of changes in the underlying true elasticities over time.

To ensure that my estimated demand elasticities are valid for forecasting purposes, I undertook a project last fall which estimated each demand equation over a series of sample periods, each of which started at the same time, but which ended at various times through the end of the full sample period. This process parallels the process alluded to in section f. of your question. Comparing the elasticity estimates across these sample periods can be helpful in identifying possible changes in elasticities over time. This exercise led, for example, to the decision to allow the elasticity with respect to employment in the single-piece First-Class letters equation to decline over time.

In the case of single-piece First-Class letters, this exercise makes clear that the estimated own-price elasticity for single-piece First-Class letters is stable across various sample periods. Hence, to answer your question here, the specific factors which appear to have led to the changes in my own-price elasticity estimates across rate cases appear to be the changes in the variables

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF ABA&NAPM

included in the single-piece First-Class letters equation. In this case, this would include replacing permanent income with private employment, allowing the elasticity with respect to employment decline over time, and replacing consumption expenditures on Internet Service Providers with the Internet Experience variable described in my testimony.

c. The three principal changes to the workshared First-Class letters equation from R2001-1 to R2005-1 which appear to have had the most significant impact on my estimate of the workshared First-Class letters own-price elasticity were shortening the sample period to begin in 1991Q1 (versus 1983Q1 in R2001-1 and earlier), the inclusion of the number of Broadband subscribers, and the inclusion of a dummy variable starting in 1993Q1 reflecting a change in the way in which workshared letters volume was calculated by the Postal Service.

Because of the shorter sample period over which the workshared First-Class letters elasticities are estimated (1991Q1 – 2005Q1) as compared with the single-piece First-Class letters sample period (1983Q1 – 2005Q1), the exercise described in section b. above is less informative for workshared First-Class letters than for single-piece First-Class letters. For example, the coefficient on the number of Broadband subscribers has the wrong sign when the workshared letters equation is stopped in either 2000 or 2001. This makes the other elasticities less trustworthy in these cases.

Nevertheless, the results of the exercise which I performed last fall were generally supportive of the notion that the estimated own-price elasticity of workshared First-Class letters is stable throughout its sample period (i.e., since 1991).

d. The significant change in the estimated coefficient associated with the worksharing discount for single-piece and workshared First-Class letters between R2000-1 and R2001-1 was the result of a specification change which recognized that this elasticity has very likely fallen over time with respect to workshared First-Class letters. Starting in R2001-1, therefore, the discount elasticity with respect

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF ABA&NAPM

to workshared First-Class letters was modeled as declining over time as the ratio of workshared letters to single-piece letters has grown over time. The treatment of the workshared discount in the First-Class letters demand equations is described on pages 50 – 53 of my testimony in this case.

The changes in discount coefficients between R2001-1 and R2005-1 were driven by the same factors which drove the changes in the estimated own-price elasticity of workshared First-Class letters as described in my response to part c.

e. Confirmed. As explained in my responses to parts b. and c. above, the changes in elasticity estimates in this case were the result of changes to the demand specifications used in this case. In all cases, these changes in the demand specifications represent improvements over the demand specifications estimated in earlier rate case. The general process by which I decide when and how to change demand specifications was described in Library Reference LR-K-65 as follows:

The process by which the final demand equations presented in my testimony were chosen was a fairly comprehensive process. First, possible explanatory variables were only investigated as candidates for inclusion in specific demand equations when there was a compelling theoretical rationale for their inclusion. In all of the cases considered here, there was a definite expectation regarding the sign of the coefficient on the variable being investigated (e.g., macro-economic variables were expected to have positive coefficients, Internet variables were expected to have negative coefficients).

A variable which had a coefficient of the opposite sign of what was expected was immediately discarded as a candidate variable. A variable which had a coefficient of the correct sign, however, may have been retained even if the coefficient were not statistically significant.

In such cases, the significance (or lack thereof) was considered vis-à-vis the theoretical significance of the variable (e.g., own-price variables which produced negative coefficients were always kept regardless of the significance of the own-price elasticity) and also vis-à-vis the importance of the variable for forecasting purposes (e.g., some of the recent negative trends were retained despite having coefficients which may not have been significant at a 95 percent, or possibly even 90 percent, confidence level).

The principal regression diagnostic which I considered in choosing among candidate equations was mean-squared error, which is equal to the sum of squared residuals divided by degrees of freedom, so lower

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

mean-squared errors are generally to be preferred. The t-statistic on the coefficient of the variable of interest was also used in some cases to decide between multiple variables which presented similar theoretical candidacies.

Finally, because the ultimate purpose of these demand equations is, of course, to develop volume forecasts, recent residuals may have been given greater weight than earlier residuals. In many cases, mean-squared errors were calculated over the most recent one to five years (in these cases, calculated as sum of squared residuals divided by the total number of observations over the relevant time period) to provide an additional diagnostic tool.

f. Confirmed. As I explained in my response to b., I performed such an analysis in the fall of 2004. In response to this interrogatory, I have updated these results to reflect the final demand specifications presented in my testimony for single-piece and workshared First-Class letters using sample periods ending in 1997, 2000, and 2001. These results are presented at the conclusion of this response. The results presented here for workshared First-Class letters should be viewed with extreme caution as they rely on extremely short sample periods which lead to generally unreliable results.

It would not be possible to obtain meaningful results using a sample period beginning in 1998 due to a lack of degrees of freedom.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF ABA&NAPM

ABA&NAPM/USPS-T7-6.

With respect to your answer that it is "not clear" what is referred to in the introductory sentence to the interrogatory, here are some quotes from your recent rate case testimonies.

"While it would certainly be better if one could include an explanatory variable that is more pleasing theoretically than simply "time" or a "trend", the failure to include any variable to account for observed behavior may bias one's other coefficient estimates. In cases of this type, it may therefore be necessary to introduce some type of trend variable into certain demand equations.

Several mail volume equations include some type of trend. For example, the First-Class letters equations include logistic trend variables which are discussed above." (R2001-1, USPS-T-8, p. 115, lines 1-7)

"As recently as the R2000-1 rate case, for example, the Internet was not explicitly included as an explanatory variable in any of the mail demand equations used for forecasting." (R2005-1, USPS-T-7, p. 24, lines 6-7.)

"It is always desirable to be able to explain the behavior of a variable that is being estimated econometrically as a function of other observable variables. Occasionally, however, the behavior of a variable is due to factors that do not easily lend themselves to capture within a time series variable suitable for inclusion in an econometric experiment. It is not uncommon for such phenomena to be modeled in part through the use of trend variables." (R2005-1, USPS-T-7, pp. 33-34.)

In a general demand equation, including that for a postal product such as FCLM, where the quantity demanded is represented on the lhs in the equation as the dependent variable, the independent explanatory variables which appear on the rhs of the equation include the price of the good, the prices of competing substitutes, income and other variables which may affect quantity demand of the good in question. You have used "time trend" variables and also "logistics market penetration variables" in place of data on the prices of competing substitutes, and until this rate case in place of any type of explicit consideration of the Internet competing substitute and the electronic payments system competing substitute for FCLM. In this rate case you have used an "Internet Experience" variable which you have constructed out of Global Insight's ISP expenditures time series.

- a. You state the ISP price index has "not exhibited any discernible trend over the past several years." (R2005-1, USPS-T-7, p. 27, lines 5-6.) However, that impact of the earlier price declines you have noted likely operate with a long lag period, as banks and others make investments to eventually take advantage of the new competing substitute. Did your experimental modeling include estimating the lagged impact of the ISP price index declines on the demand for FCLM? If so, what were the results, if not why did you not perform such an experiment?

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

- b. You state on p. 32, starting at line 10 of your testimony in this case that using NACHA time series "tended to be less robust within the econometric demand equations. I think this is because electronic diversion of the mail is a very generalized risk." Have you tested the robustness of this data, [or the quarterly time series data on commercial check volumes, which exists back to at least 1995Q1] against the specific portions of FCLM volumes that electronic payments systems divert, such as billing statements and bills paid through the mail (or for checks, the impact on extra ounce volume, which is a reasonable proxy for bank statements sent through the mail with canceled checks in the mail piece)? If your answer is "yes", please provide a complete answer to what your findings were. If your answer "is no", please explain why you have not done such tests.
- c. In your answer to a. you agree that "In general, it is true that high cross-price elasticities of demand are often associated with high own-price elasticities of demand..." Since you have price data, both nominal and real on postal prices, and since there is voluminous time series available for revenue and/or volume variations for the Internet competing substitute and the electronic payments system (both transactions data and check volume data), econometric modeling of cross price elasticities is possible. Have you conducted any such estimates of cross price elasticities? If so what were the results and how high were those elasticities, if not why not?

RESPONSE:

- a. I have not experimented with the ISP price index as a possible explanatory variable in the First-Class letters demand equations. It is my opinion that substitution between First-Class Mail and Internet alternatives is not driven by the relative prices of these two media so much as by the extent to which electronic alternatives to the mail exist and are utilized. In particular, it is difficult empirically to evaluate the price of an alternative which is not available. That is, what was the price of electronic bill-payment in the late 1980s when electronic bill-payment was not available?

Further, in most cases, once electronic alternatives become widely available and are utilized, it does not appear to me that such alternatives compete at the margins with First-Class Mail based on price. For example, I currently pay my Discover card bill online at Discover's web site. The cost to me of doing so is nothing. While it may be true that this price (\$0) as compared with the price of paying via the mail (\$0.37 plus the cost of a check) was relevant in my decision to begin to use this service, the specific

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

difference in these prices is no longer relevant to my decision to continue to pay electronically. That is, the Postal Service could cut its First-Class Mail price to ten cents and it would still be sufficiently more expensive than the electronic alternative that I would be skeptical of such a move inducing many, if any, bill-payers to switch from electronic alternatives to a mail-based payment system.

b. I have not attempted to estimate demand equations for specific segments of First-Class Mail volume due to a lack of reliable data on the specific mail volumes within such segments.

c. Personally, I would not consider the amount of "time series data available for revenue and/or volume variations for the Internet competing substitute and the electronic payments system (both transactions data and check volume data)" to be "voluminous." Further, as explained in my response to part a. of your question above, I am skeptical of modeling cross-price relationships between First-Class Mail and electronic alternatives. I have, however, experimented with some data on electronic bill-payment volumes as a possible explanatory variable in the demand equations for First-Class Mail. Results of these experiments are presented and briefly discussed in USPS-LR-K-65 at pages 4 – 353.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

ABA&NAPM/USPS-T7-7.

- a. You assert in your answer to ABA&NAPM/USPS-T7-2 parts b. and c. that your estimated own price elasticity for single piece FCLM is "stable" across various sample periods, but do not state what it is. What is that "stable" value?
- b. You assert that your estimated own price elasticity for workshared FCLM is "stable" across vary sample periods, but do not state what it is. What is that "stable" value?
- c. Your econometric specification presumes constant elasticity of substitution (CES), it does not offer any proof, or derive any conclusion whatsoever, that postal demand curves are in fact CES demand curves. In your tests over sample periods, have you also presumed a CES specification? Have you run your sample data under any econometric demand specification that allows for varying elasticity of substitution, as opposed to CES? If you are testing, as you claim, whether elasticities are varying over time by choosing different sample periods, how can you conduct such a test when you largely (if not entirely) rule out by virtue of the CES functional form, the very question you are trying to investigate, i.e. variation in own price elasticities?
- d. What do you mean by "changes in econometric methodology", the last of four factors you mention in your answer to b. as being possible causes of changes in demand elasticities for FCLM? Under that term, are you including the use of explicit variables for competing substitutes? If not, then why would you not include the influence of competing substitutes as one factor that could influence estimated own price elasticities, or would this be a "fifth" "possible factor"?
- e. You state in your answer to b. that in your experiments with various sample periods, the own price elasticity for single piece and also for workshared emerged as stable across various sample periods. However, in c. you appear to contradict that statement by stating that three changes to the workshared demand equations "appear to have had the most significant impact on my estimate of the workshared First-Class letters own price elasticity", and you go on to list those three changes, among them shortening the sample period to start at 1991Q1 rather than 1983Q1. Please reconcile these two statements.
- f. You indicate in your answer to b. that you included the number of Broadband subscribers in your workshared equations. Did you include the number of Broadband subscribers in your single piece equations, as well as your workshared equations? If so, what were the results? If not, why not, given your statement to the effect that households are increasingly paying bills online?
- g. For workshared letter demand equations, you state your experiments were "generally" supportive of a stable own price elasticity since 1991. This appears to be a somewhat weaker statement than you made in your answer concerning

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

single piece elasticities. In what specific non-general areas did you find evidence that workshared elasticities were not necessarily stable? Please provide all details of your conclusions.

- h. In your answer to e. you state the changes to your demand elasticities in this case "were the result of changes to the demand specifications used in this case". Over the historical period between R2001-1 and R2005-1, as indicated from the (latest available) 2003 Household Diary Study and considerable other evidence, there has been substantially greater diversion of payment mail (bills sent and bills paid) to electronic payments systems and substantially greater diversion of what the Diary defines as "transactions" related mail to the Internet. Are you saying these impacts had no influence on your demand elasticities? Or, that you are unable to measure these impacts because your demand equations presume constant elasticity of substitution? Or, by the term "demand specifications" are you including the impact from competing substitutes such as the Internet and electronic payments systems?

RESPONSE:

- a. It is my belief that the own-price elasticity of single-piece First-Class letters volume is approximately -0.175 as presented in my testimony.
- b. It is my belief that the own-price elasticity of workshared First-Class letters volume is approximately -0.329 as presented in my testimony.
- c. It is true that I assume a constant-elasticity specification, both in the demand equations to which I testify in this case, as well as in the experiments which I undertook to investigate the stability of the price elasticities which I use in this case. I would strongly disagree with your assertion, however, that such an assumption "rule[s] out ... the very question you are trying to investigate." If the true own-price elasticity of single-piece First-Class letters changed between, say, 2000 and 2004, then an own-price elasticity estimate obtained using data through 2000 would be different from an own-price elasticity estimate obtained using more recent data, even if both estimates assumed constant own-price elasticities throughout the relevant sample periods. In fact, however, as presented in my response to ABA&NAPM/USPS-T7-2(f), the

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

estimated own-price elasticity using data through 2000Q4 (-0.181) is virtually identical to the estimated own-price elasticity using data through 2005Q1 (-0.175).

Within the context of my own-price elasticity estimates, the term "constant-elasticity specification" refers to the relationship between the own-price elasticity and the volume and price of the relevant mail category. That is, alternatives to a "constant-elasticity specification" would posit some relationship between the own-price elasticity of single-piece First-Class letters and the volume and price of single-piece First-Class letters. While such a relationship would not be "constant" in the sense that it could vary with changes in volume and/or price, the relationship between the own-price elasticity and volume and price would nevertheless remain unvarying throughout the sample period in such a case.

The "constant-elasticity specification" is no less amenable to an assumption that the own-price elasticity has either changed over time or is a function of some other explanatory variable than any other functional form. In fact, an example of the former, a "constant-elasticity specification" elasticity which changes over time, can be found within the single-piece First-Class letters specification presented in my testimony, which posits that the elasticity of single-piece letters with respect to employment has declined over time.

d. By "changes in econometric methodology" I was thinking of methodological changes to my econometric estimation procedure. For example, changing from a log-log functional form to a linear functional form would fall into this category, or a decision to begin to test for and correct fourth-order autocorrelation would represent a change in "econometric methodology."

I would consider "the use of explicit variables for competing substitutes" to be an example of "changes in the demand specification," which was the first of my four factors defined in ABA&NAPM/USPS-T7-2(b).

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

e. My experiments with various sample periods to which I refer in my response to ABA&NAPM/USPS-T7-2(b) held the specification and starting period constant and varied only the ending date of the demand equations. Hence, my response to ABA&NAPM/USPS-T7-2(c) was intended to explain that the differences in price elasticity estimates across rate cases was **not** suggestive of changes in true price elasticities within the time period over which these price elasticities are modeled in **this case**, but was solely the result of changes in the demand specification used in this case.

f. I did investigate the number of Broadband subscribers in the single-piece First-Class letters equation. Results of such experiments are presented in USPS-LR-K-65 at pages 23 – 37.

g. Because of the shorter sample period over which the workshared First-Class letters equation is estimated (starting in 1991Q1 as compared to 1983Q1 for single-piece letters), the own-price elasticity estimates across various sample periods that I described in my response to ABA&NAPM/USPS-T7-2 exhibited a somewhat greater range of elasticity estimates. For example, the workshared letters own-price elasticity estimates presented in my response to ABA&NAPM/USPS-T7-2(f) ranged in value from -0.128 to -0.568. While there is no evidence here of a trend, nevertheless, the range of own-price elasticity estimates is quite large. In contrast, the own-price elasticity estimates associated with single-piece letters in that same response range from -0.153 to -0.182, which is, of course, a much tighter range.

h. My use of the Internet Experience variable as a measure of the effect of the Internet on First-Class single-piece letters volume would be one example of a change in

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

demand specification. Beyond that, however, I am asserting that the true own-price elasticity of First-Class single-piece letters appears not to have been directly impacted by the increased use of electronic alternatives in recent years. For example, as noted above, as presented in my response to ABA&NAPM/USPS-T7-2(f), the estimated own-price elasticity using data through 2000Q4 (-0.181) is virtually identical to the estimated own-price elasticity using data through 2005Q1 (-0.175), which suggests to me that the own-price elasticity of First-Class single-piece letters has not changed as a result of changes in the availability and use of electronic alternatives over the past four years.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

ABA&NAPM/USPS-T7-8.

- a. In your response to ABA&NAPM/USPS-T7-3, question b., there was a typo. "R2001-1" should have read "R2000-1". With that correction, please answer the original question, parts b. as well as c.
- b. With respect to your answer to part c. in this original interrogatory, you avoid a direct answer to the question about rising postal rates influencing the decline in check volumes by stating that check volume "is affected by many factors beyond the price of additional ounces charged by the postal service" and you note that the total volume of checks has "fallen consistently" since "1995".
Do you have any evidence that increasing postal rates, including the extra ounce rate since the implementation of that rate increase from R2000-1, have not been one of the "many factors" causing the decline in check volumes?
Do you have any evidence that the extra ounce rate hike emerging from R2000-1 was not the predominant factor after 2001Q4 that continued to reduce check volume further, and accelerated the decline?

RESPONSE:

- a. Just to be clear, I think the typo was in the question, rather than in my response.
While it is undoubtedly true that the additional ounce rate charged by the Postal Service will affect the volume of First-Class Mail weighing more than one ounce, it seems to me, in looking at the history of additional ounce volume, without having studied this issue very closely at all, that price is likely only one of many factors that affect the volume of additional ounces.
- b. I have no evidence that postal rates have not affected check volumes. I have not performed any specific analysis of check volumes, so I would consider myself unqualified to offer any definitive evidence one way or the other on this topic.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

.. ABA&NAPM/USPS-T7-10.

In your response to ABA&NAPM/USPS-T5, you define your use of the term "long run", whereas the question specifies precisely the context in which it uses the term "long run", namely your use of data that goes all the back to 1991 for workshared letters and all the way back to 1983 for single piece letters.

- a. Would you agree that the competitive market environment for Postal Services in 1983 did not include Internet competition and electronic payments systems?
- b. Would you agree that if there were enough rate data from cross-sectional variation in real and/or nominal postal rates were the setting a free market rather than a regulatory one for postal services, that you would have a more accurate estimate of current own price elasticities for postal products than is possible by using time series data dating back to 1983?
- c. Would you agree that whatever the short run "lagged prices" that impact TY2006 post rate increase volumes are, that your use of, for example 1983-1987 data, in estimating CES own price elasticities is also influencing those test year volume forecasts? If your answer is anything other than an unequivocal "yes", please fully explain your answer.

RESPONSE:

- a. Yes.
- b. More data will generally lead to more accurate elasticity estimates.
- c. Yes. It is my opinion that, consistent with my answer to part b. above, the use of 1983 – 1987 data increases the accuracy of the elasticity estimates which I use in this case.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF ABA&NAPM

ABA&NAPM/USPS-T7-11.

Please confirm from your testimony in this case that the computed own price elasticity for FCLM workshared letters is greater than that for Standard A Regular letters, namely -0.376 versus -0.267 .

RESPONSE:

The computed own-price elasticity for First-Class workshared letters which I cite in my testimony is -0.329 . However, great care needs to be taken in interpreting the First-Class price elasticities which I have presented in this case. See pages 67 through 70 of my testimony for a detailed discussion of this issue.

GCA/USPS-T7-1

Please refer to your testimony, USPS-T-7, p.22.

- a) In general in applied econometrics, do you agree that substituting one variable for another one may affect the estimated coefficients whether the variable is conceptually relevant or not, and even if it is highly significant statistically? If your answer is not an unequivocal "yes," please explain.
- b) Please confirm that in the current rate case you replaced the income variable you used in R2001-1, with an employment variable.
- c) Please confirm that employment variable is used as a proxy for economic activity.
- d) Please explain the economic rationale for the substitution noted in b) above, in light of the fact that in prior testimony (R2000-1, USPS-T7, starting at page 92) you spent considerable effort justifying the income variable, for example, with reference to the permanent income hypothesis.
- e) Please state why you did not use GDP (or Industrial Production) as a proxy for economic activity instead of employment.
- f) Please explain whether the inclusion of GDP (or Industrial Production) could have resulted in a different effect on the coefficients.

RESPONSE

- a) Yes.
- b) Confirmed.
- c) Confirmed.
- d) As explained in my testimony at page 22, line 21, through page 23, line 7,

Employment is an excellent measure of the overall level of business activity in the economy. In many cases, mail volume is not affected by the dollar value of economic transactions, so much as by the number of such transactions. For example, the number of credit card bills one receives does not necessarily go up as the total amount charged per card goes up. While variables like retail sales may be good measures of the total dollar amount of economic activity (e.g., the total amount charged per credit card), employment appears to be a better measure of the number of business transactions (e.g., number of credit card bills received).

Ultimately, the choice of which macroeconomic variables to use in the demand equations discussed here was largely an empirical decision. In those cases where employment is used as an economic variable in the Postal demand equations, its inclusion clearly improved the econometric fit for these equations.

e) First-Class letters are primarily consumer-driven, so my focus in modeling the relationship between the economy and First-Class Mail volume has tended to focus on consumer variables such as income, consumption, sales, and employment, as opposed to business variables such as GDP, investment, or industrial production. Econometric results using several possible economic variables in the single-piece First-Class letters equation are presented in Library Reference LR-K-65 in this case at pages 812 – 985.

I have experimented with Industrial Production as a possible explanatory variable in the past. My recollection is that Industrial Production did a relatively poor job of explaining the demand for First-Class Mail.

The general bases by which I decide which variables to include in my demand equations are described in Library Reference LR-K-65 at pages 2 - 3.

f) Yes. Replacing employment with GDP could be expected to affect not only the coefficient of GDP, but also the other coefficients in the single-piece First-Class letters equation. In my opinion, such coefficients would be less accurate than the coefficients to which I am testifying in this case.

GCA/USPS-T7-2

Please refer to your testimony, USPS-T-7, Section III., starting at p. 254. Please confirm that you have tested for the normality assumption that is required for the t-tests you have given for the coefficients to hold. If confirmed please provide the tests. If not confirmed, please conduct the tests and provide them.

RESPONSE

Formal tests for normality have been periodically administered by me and others on Postal demand equations in the past. Such tests were not conducted for the specific equations presented in my testimony. The formal results of several normality tests for each of the twenty-seven demand equations presented in my testimony are presented on the next page.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF GCA

300

Results of Tests for Normality in the Residuals (AR-Corrected)

Null hypothesis: Residuals are Normally Distributed

Rejection of the null hypothesis at the 5% significant level is in bold)

	Jarque-Bera Test	Shapiro- Wilk	Shapiro- Francia
First-Class Letters			
Single-Piece	0.599	0.988	0.989
Workshared	0.446	0.982	0.985
First-Class Cards	0.416	0.994	0.995
Priority Mail	3.310	0.967	0.968
Express Mail	0.454	0.989	0.991
Mailgrams	120.143	0.878	0.866
Periodical Mail			
Within-County	14.091	0.955	0.952
Nonprofit & Classroom	3.646	0.984	0.981
Regular Rate	0.726	0.988	0.989
Standard Mail			
Regular Rate	2.703	0.973	0.977
Enhanced Carrier-Route	0.948	0.990	0.994
Bulk Nonprofit	0.045	0.990	0.990
Package Services			
Parcel Post			
Non-Destination-Entry	0.932	0.972	0.974
Destination-Entry	0.681	0.980	0.987
Bound Printed Matter	0.821	0.986	0.988
Media & Library Rate	0.680	0.984	0.987
Postal Penalty	0.143	0.996	0.995
Free-for-the-Blind	10.102	0.980	0.977
Special Services			
Registered	2.742	0.972	0.968
Insurance	34.040	0.967	0.963
Certified	35.695	0.965	0.959
COD	4.997	0.979	0.977
Money Orders	5.408	0.962	0.962
Return Receipts	0.405	0.954	0.957
Delivery Confirmation	1.540	0.947	0.951
Stamped Cards	0.100	0.979	0.978
Post Office Boxes	2.052	0.970	0.978

**RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA**

GCA/USPS-T7-3

Please refer to your testimony USPS-T-7, Section III., starting at p. 254.

- a) Please confirm that it is a required condition in your regression analysis that variables be stationary.
- b) Please confirm that if variables are non-stationary, the results may be spurious.
- c) Please confirm that if the regression result is spurious, the estimated coefficients may not be correct.
- d) Please confirm that you have conducted the appropriate tests for the stationary character of the variables. If confirmed, please provide those tests. If not confirmed, please conduct the tests and provide the tests results.
- e) Please confirm you have corrected for the non-stationary character of the data if present. If confirmed, please explain how you accomplished that. If not confirmed, then explain on what basis you conducted your regressions.

RESPONSE

a) Not confirmed. The properties of Generalized Least Squares should be satisfied so long as some stationary linear relationship exists between variables. It is a sufficient condition, therefore, to have stationary dependent variables. The Generalized Least Squares assumptions may be satisfied even with non-stationary variables, however, so long as a stationary linear relationship exists between the dependent and independent variables using in the equation. In such a case, the true residuals in the regression specification should be stationary.

b) Confirmed.

c) Confirmed.

d) Confirmed. I have performed stationarity tests on the data which I use in my demand analysis on several occasions in the past. Results of investigating the stationarity of mail volumes using a Dickey-Fuller test which were conducted in the fall of 2004 are presented below. A more comprehensive investigation of

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

possible stationarity and co-integration issues was conducted by my staff in
2002.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF GCA

Dickey-Fuller Test of Unit Root (Volume variable only)

	Starting Date	Constant and Trend		Constant and no Trend		No Constant no Trend	
		t-Statistic	Test Critical Values	t-Statistic	Test Critical Values	t-Statistic	Test Critical Values
FIRST-CLASS MAIL							
First-Class Letters & Flats	1970:1	-8.7004	-3.4427	-5.0723	-2.8824	-1.6284	-1.9432 *
-- Single-Piece	1970:1	-9.8483	-3.4427	-4.3528	-2.8824	-4.2629	-1.9432
-- Workshared	1976:1	-5.5570	-3.4508	-6.6716	-2.8877	-7.2127	-1.9437
First-Class Cards	1970:1	-4.8732	-3.4427	-2.5708	-2.8824 *	-0.4168	-1.9432 *
-- Single-Piece	1970:1	-4.6343	-3.4427	-4.4955	-2.8824	0.2011	-1.9432 *
-- Workshared	1976:1	-9.3641	-3.4508	-3.6390	-2.8877	-1.4649	-1.9437 *
Priority Mail	1970:1	-3.1121	-3.4427 *	-1.3124	-2.8824 *	-0.8010	-1.9432 *
Express Mail	1977:1	-4.2688	-3.4512	-7.7846	-2.8879	-4.0479	-1.9438
Mailgrams	1974:4	-4.1088	-3.4480	-0.7004	-2.8859 *	0.9002	-1.9435 *
PERIODICAL MAIL							
Within County	1970:1	-3.3855	-3.4427 *	-0.9144	-2.8824 *	1.4071	-1.9432 *
Nonprofit	1970:1	-7.0748	-3.4427	-2.7774	-2.8824 *	0.3635	-1.9432 *
Classroom	1970:1	-7.9730	-3.4427	-6.9952	-2.8824	-0.1735	-1.9432 *
Classroom and Nonprofit	1970:1	-6.8543	-3.4427	-2.6355	-2.8824 *	0.3980	-1.9432 *
Regular Rate	1970:1	-6.0134	-3.4427	-3.3244	-2.8824	0.6131	-1.9432 *
STANDARD MAIL							
Regular Rate Bulk							
Regular	1970:1	-3.1386	-3.4427 *	-1.3964	-2.8824 *	-1.0240	-1.9432 *
-- Basic ECR Letters	1993:1	-4.2457	-3.5107	-1.8553	-2.9266 *	-0.8357	-1.9481 *
-- Basic ECR Nonletters	1993:1	-3.9919	-3.5107	-3.6527	-2.9266	-0.5430	-1.9481 *
Enhanced Carrier-Route	1979:2	-5.9155	-3.4549	-6.6924	-2.8903	-4.3511	-1.9440
High Density/Saturation Letters	1993:1	-2.9320	-3.5107 *	-2.5089	-2.9266 *	-0.4549	-1.9481 *
High Density/Saturation Nonletters	1993:1	-6.2134	-3.5107	-4.3347	-2.9266	-0.3698	-1.9481 *
Nonprofit Rate Bulk							
Nonprofit	1970:1	-8.5504	-3.4427	-6.3978	-2.8824	-0.5999	-1.9432 *
-- Basic ECR Letters	1993:1	-8.3013	-3.5107	-8.3914	-2.9266	-0.1453	-1.9481 *
-- Basic ECR Nonletters	1993:1	-5.4841	-3.5107	-4.2095	-2.9266	-0.0956	-1.9481 *
Nonprofit ECR	1980:3	-6.6764	-3.4573	-6.5317	-2.8919	-1.7707	-1.9442 *
High Density/Saturation Letters	1993:1	-4.7210	-3.5107	-3.5663	-2.9266	-0.9662	-1.9481 *
High Density/Saturation Nonletters	1993:1	-3.8398	-3.5107	-1.7962	-2.9266 *	-0.4224	-1.9481 *
PACKAGE SERVICES							
Parcel Post							
Non-Destination Entry	1970:1	-4.0578	-3.4427	-3.9722	-2.8824	0.0013	-1.9432 *
Destination Entry	1970:1	-7.1372	-3.4427	-2.9272	-2.8824	0.3877	-1.9432 *
Bound Printed Matter	1991:2	-3.9801	-3.4970	-4.4542	-2.9177	-2.1577	-1.9471
Media Mail	1970:1	-14.0523	-3.4427	-5.7088	-2.8824	-0.8554	-1.9432 *
Library Rate	1970:1	-4.4472	-3.4427	-2.2023	-2.8824 *	0.4633	-1.9432 *
Media Mail and Library Rate	1970:1	-5.6592	-3.4427	-3.4052	-2.8824	0.0998	-1.9432 *
	1970:1	-6.3774	-3.4427	-2.3755	-2.8824 *	0.4023	-1.9432 *
Postal Penalty	1988:1	-6.2140	-3.4794	-4.0298	-2.9062	-0.0206	-1.9458 *
Free-for-the-Blind	1970:1	-10.4610	-3.4427	-6.6492	-2.8824	-0.5139	-1.9432 *
Registered Mail	1970:1	-3.4053	-3.4427 *	-0.0482	-2.8824 *	1.7457	-1.9432 *
Insurance	1970:1	-5.8137	-3.4427	-4.0626	-2.8824	0.1121	-1.9432 *
Certificated Mail	1970:1	-6.1692	-3.4427	-2.2587	-2.8824 *	-0.9805	-1.9432 *
COD	1970:1	-3.7933	-3.4427	-0.2569	-2.8824 *	1.8375	-1.9432 *
Return Receipts	1970:1	-4.6968	-3.4427	-4.6965	-2.8824	-0.1878	-1.9432 *
Money Orders	1970:1	-2.1205	-3.4427 *	-2.2071	-2.8824 *	0.7204	-1.9432 *
Delivery and Signature Confirmation	1999:2	-8.3619	-3.6450	-6.6799	-3.0124	-3.2418	-1.9581
Post-Office Boxes	1993:1	-3.9806	-3.5107	-3.1235	-2.9266	0.1902	-1.9481 *
Stamped Cards	1970:1	-3.5371	-3.4427	-2.4179	-2.8824 *	0.6065	-1.9432 *
Stamped Envelopes	1993:1	-4.0725	-3.5107	-4.0488	-2.9266	-0.0034	-1.9481 *

(*) Unit root hypothesis is not rejected at 5%

Asymptotic critical values for unit root test by Davison and MacKinnon:

%5 critical value	
t _{ct}	-3.4100
t _c	-2.8600
t _{nc}	-1.9400

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

e) The results of the reports cited in my response to d above suggested that stationarity did not appear to be a particular concern in the analysis of mail volume demand equations. In addition, Dickey-Fuller tests on the residuals from my regressions indicate the presence of no unit roots. Hence, to the extent some of the dependent variables may appear non-stationary, there appears to nevertheless exist a stationary linear relationship between the dependent and independent variables in every case here.

GCA/USPS-T7-4

Please refer to your testimony, USPS-T-7, Section III, starting at p. 254.

- a) Please confirm that one requirement for using regression is the absence of heteroscedasticity.
- b) Please confirm that the presence of heteroscedasticity would affect the coefficients and the test results.
- c) Please confirm that you have conducted the appropriate tests for heteroscedasticity. If confirmed, please provide the tests results. If not confirmed, please conduct the tests and provide them.
- d) In your opinion, have the estimated coefficients you have provided in your testimony been stable over the whole period of 1983-2004? State the full basis for your opinion if you confirm, or if you do not confirm, including current or prior tests done.

RESPONSE

- a) Confirmed.
- b) A failure to correct for the presence of heteroscedasticity may lead to inefficient coefficient estimates and may invalidate the statistical properties of the sample variance. In general, however, coefficient estimates will still be unbiased even in the presence of heteroscedasticity.
- c) Heteroscedasticity tends to be more of a problem when using cross-sectional data than when using time series data. Because my demand equations are built using time series data, heteroscedasticity is less likely to be problematic than autocorrelation, for example. Hence, I do not conduct tests for the presence of heteroscedasticity on a regular basis. I have, however, conducted such tests in the past, and, at your request, have done so for the demand equations presented in my testimony. The results of using a Breusch-Pagan test to test for heteroscedasticity are presented on the next page.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF GCA

306

Results of Breusch-Pagan Test for Heteroscedasticity

Resids = $a + b \cdot \text{Trend}$

90% Significance Level = 2.706

(significant results in bold)

First-Class Letters	
Single-Piece	0.010
Workshared	0.003
First-Class Cards	0.018
Priority Mail	0.010
Express Mail	0.005
Mailgrams	1.945
Periodical Mail	
Within-County	0.146
Nonprofit & Classroom	0.143
Regular Rate	0.031
Standard Mail	
Regular Rate	0.005
Enhanced Carrier-Route	0.009
Bulk Nonprofit	0.007
Package Services	
Parcel Post	
Non-Destination-Entry	0.015
Destination-Entry	0.003
Bound Printed Matter	0.140
Media & Library Rate	0.123
Postal Penalty	0.427
Free-for-the-Blind	4.861
Special Services	
Registered	0.118
Insurance	0.292
Certified	0.328
COD	0.648
Money Orders	0.010
Return Receipts	0.012
Delivery Confirmation	0.058
Stamped Cards	0.282
Post Office Boxes	0.015

d) Yes. I undertook a project last fall which estimated each demand equation over a series of sample periods, each of which started at the same time, but which ended at various times through the end of the full sample period.

Comparing the elasticity estimates across these sample periods can be helpful in identifying possible changes in elasticities over time. This exercise led, for example, to the decision to allow the elasticity with respect to employment in the single-piece First-Class letters equation to decline over time.

Summary results for single-piece and workshared First-Class letters estimated over various sample periods which parallel this project using the R2005-1 demand equation specifications are presented in my response to ABA&NAPM/USPS-T7-2.

GCA/USPS-T7-5

- a) Please confirm that during the period of 1983-2004, there have been certain structural changes. If confirmed, please explain how you have accounted for all these changes.
- b) Please explain whether and how the structural changes can affect the coefficients (in other words the elasticities you have calculated).

RESPONSE

a - b) Confirmed to the extent that I understand your use of the term "structural changes." Certainly, many things have occurred since 1983 which have affected mail volume.

In some cases, these things are simply included as explanatory variables in the demand equation. For example, the effect of the seven changes to the nominal price charged for a one-ounce First-Class single-piece letter is simply modeled in the single-piece letters equation by including the real price of single-piece First-Class letters.

In other cases, where the relationship between mail volume and a particular factor appear to have changed over time, the changing nature of this relationship may be explicitly modeled. Examples of this include the negative time trend in the estimated employment elasticity in the single-piece First-Class letters equation and the changes to the own- and cross-price elasticities with respect to Priority Mail associated with the expansion of FedEx Ground.

Changes which led to level shifts in mail volume but did not appear to otherwise affect the underlying relationship between mail volume and other explanatory variables are modeled through the inclusion of simply dummy variables. Examples of this include dummy variables for classification reform (MC95-1) in the First-Class letters equations.

Finally, when there is evidence of significant changes in the underlying structure of the demand for a Postal product, the sample period over which elasticities are estimated may be truncated, if possible, to remove older data which may reflect an older, less-relevant relationship. Hence, for example, the single-piece First-Class letters equation is estimated starting in 1983Q1, because

the demand for single-piece First-Class letters in the years just preceding this was driven in large measure by shifts from single-piece to workshared First-Class letters. The workshared First-Class letters equation in this case is estimated over a sample period which begins in 1991Q1 because the factors which drove the significant growth in workshared First-Class letters volume throughout the 1980s do not appear to have affected workshared letters volume in the same way during the 1990s and 2000s.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

GCA/USPS-T7-7

- a) Please confirm that, in order to preserve the power of the model, for example in the case of First Class single piece letter mail, one should include a variable which is the multiplication of a dummy variable representing post and pre-1995 by the SP price.
- b) Please confirm that the sum of resulting coefficient of this cross-multiplication variable and the coefficient of SP price, would be the SP own price elasticity for the period 1995-2004.
- c) Please conduct the above regression and provide the results.

RESPONSE

- a) Not confirmed.
- b) Confirmed.
- c) Objection filed.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

GCA/USPS-T7-8

Please refer to your testimony, USPS-T-7, p. 57.

- a) Please explain the economic rationale for including a variable which is the cross multiplication of the employment variable and the time trend.
- b) Please explain whether the time trend variable included in this form in the regression model reflects the technological and other changes that may not have been captured by the other variables.
- c) Please confirm that the inclusion of this variable, whether it is economically relevant or not, can affect the size of other coefficients and/or their sign, as well as other test results.

RESPONSE

- a) As I explained in my testimony in this case, at page 55, lines 7 – 10:

The relationship between the economy and single-piece letters volume has lessened over time. This is reflected here in the fact that the elasticity of single-piece letters volume with respect to employment has declined over time.

Mathematically, single-piece First-Class letters volume is modeled as being affected by employment as follows:

$$\text{Volume} = a \cdot (\text{Employment})^{(e_0 - e_1 \cdot \text{Trend})} \cdot \dots$$

Converting to log-log form, then, the natural logarithm of volume would relate to employment as follows:

$$\ln(\text{Volume}) = \ln(a) + e_0 \cdot \ln(\text{Employment}) - e_1 \cdot [\text{Trend} \cdot \ln(\text{Employment})] + \dots$$

- b) This variable is intended to reflect the declining relationship between the economy (as modeled through employment) and single-piece First-Class letters volume. The reasons for this declining relationship likely include technological changes that make the use of First-Class letter mail less vital for economic transactions.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

c) Confirmed.

GCA/USPS-T7-9

Please refer to your testimony, USPS-T-7, p. 254.

- a) Please confirm that you have used a log-log form model (in other words, a constant elasticity of substitution (CES) model) in estimating the elasticities.
- b) Please confirm that one does not necessarily have to use a CES functional form to estimate elasticities.
- c) Please confirm that you could have used a linear regression or other variable elasticity of substitution demand function to estimate the coefficients and then calculated different values of price and quantity to calculate point elasticities. Please confirm that this would provide you with a time series of elasticities that reflect changing structural conditions.

RESPONSE

- a) Confirmed
- b) Confirmed
- c) Confirmed that I could have used a linear regression. I can further confirm that a linear regression specification would have resulted in elasticity estimates which varied as prices and volumes changed. Your last sentence, however, does not seem to me to be correct. While it would be true that these elasticities would change as volumes and prices changed, they would do so in a purely mechanical way which would be driven entirely by the *a priori* assumptions of the modeler in selecting the model.

Had I simply modeled First-Class letters volume as a linear function of First-Class letters price, the First-Class letters price elasticity would, in fact, be a function of the price and volume of First-Class letters, but the relationship between these variables would still be assumed to remain constant throughout the sample period of estimation.

This is no different from the constant-elasticity case used in my testimony. Deviations from the constant-elasticity assumption can be made on a case-by-case basis, as I did, for example, in the cases of the employment elasticity with

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

314

respect to single-piece First-Class letters and the own- and cross-price elasticities associated with Priority Mail.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

GCA/USPS-T7-10

Please refer to your testimony, USPS-T-7, p. 29.

- a) Please confirm that the ISP-Experience variable you constructed was on an ad-hoc basis.
- b) Please confirm that a different construct would have given different results and that the choice of this construct was made on the basis of whether it was generating a stronger statistical relationship with the quantity demanded.

RESPONSE

a) Not confirmed. The ISP Experience variable was constructed on the basis of a very specific theoretical and mathematical foundation as a measure of the total on-line experience of the Internet population of the United States. The basis upon which I constructed this variable is described in detail in my testimony in this case at pages 26 – 29.

b) Confirmed that a different construct would have given inferior results. As explained in my testimony, the Internet Experience variable was constructed to measure the total amount of Internet experience of the on-line population. Once this variable was constructed, it was then tested as a candidate explanatory variable in the First-Class Mail demand equations against other Internet variables. Comparisons of econometric results using alternate Internet measures in the single-piece First-Class letters equation are described in Library Reference LR-K-65 at pages 4 – 66.

GCA/USPS-T7-11

Please refer to your testimony, USPS-T-7, especially Section II. B., **and** the table showing the history of rate case own price elasticities for FCLM attached as a separate page and designated Exhibit A.

- a) On average over the history of those rate case elasticity calculations for FCLM, please explain why the higher postal rates have become, the more price inelastic the rate case CES demand curve has become?
- b) Do you agree that there is persuasive empirical evidence of (i) increasing use of the Internet as a competitive substitute for FCLM and (ii) increasing use of electronic payments as a competitive substitute for postal services? If your answer is not an unqualified "yes," please explain how you would reconcile the history of increasingly inelastic rate case CES demand curves with such empirical evidence.

How do you reconcile this history of increasingly inelastic rate case CES demand curves with the statement made at recent Senate committee hearings by PMG Potter to the contrary, viz. "Electronic diversion continues to erode First-Class Mail volume, this product will become more price-sensitive than ever. Higher rates will likely increase the pace of change, accelerating the volume decline, resulting in falling revenue...."

RESPONSE

a) I see no evidence in Exhibit A that your statement that "the higher postal rates have become, the more price inelastic the ... demand curve has become" is true.

The price elasticities presented by me in this and earlier rate cases (as well as those presented by Dr. George Tolley prior to R97-1) were estimated using real Postal prices. The real price of single-piece First-Class letters, as used by me in this case, has declined from 44.01 cents in 1983Q1 (expressed in 2000 dollars) to 41.74 cents in 2005Q1 (again expressed in 2000 dollars).

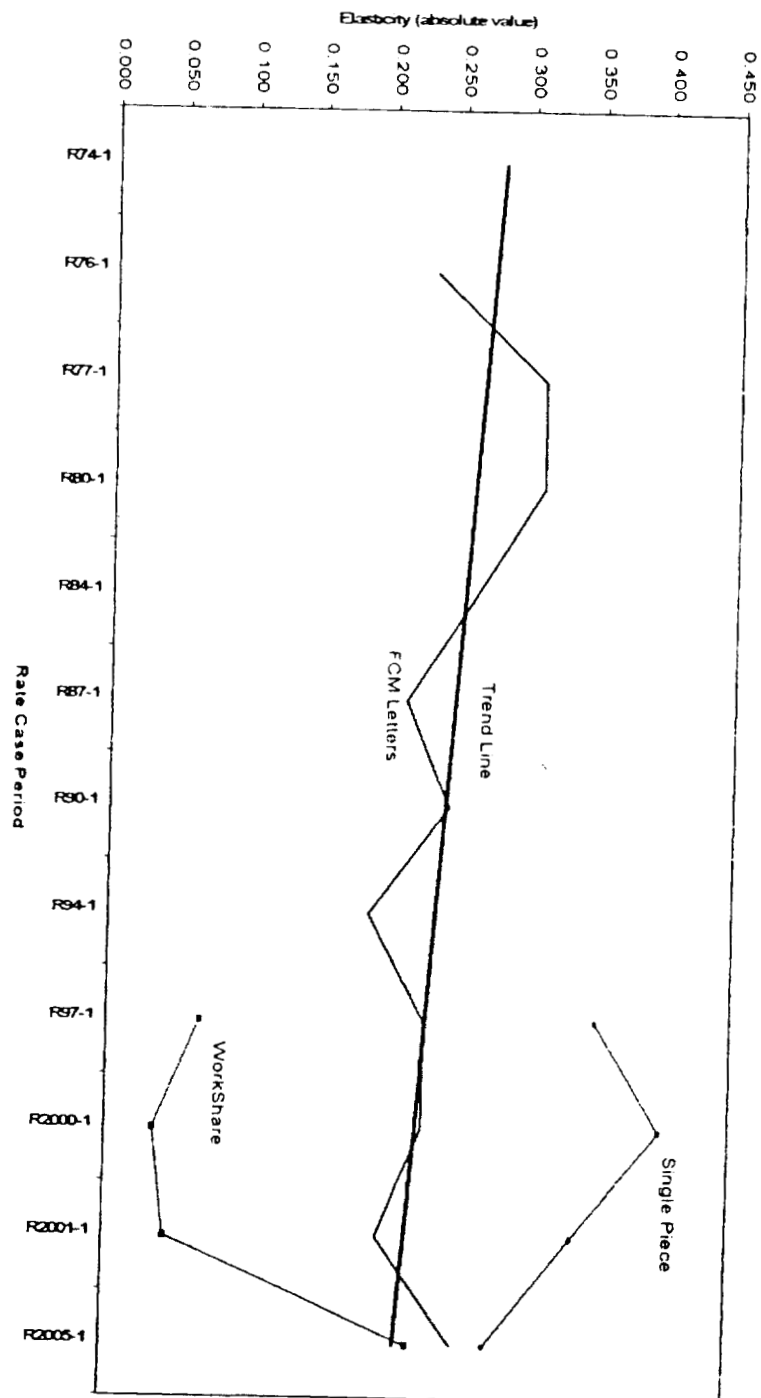
Further, my current First-Class letters demand equations are estimated using sample periods which begin in 1983Q1 (single-piece) and 1991Q1 (workshared). Looking at your Exhibit A and removing those rate changes which took place prior to 1983Q1 (R80-1 and earlier), about which I have never provided any testimony regarding price elasticity, there appears to me to be no

evidence of any discernible trend in the estimated own-price elasticity of First-Class letters presented in Postal Service rate cases.

b) Yes.

With respect to the issue of reconciling "this history of increasingly inelastic rate case CES demand curves with the statement made at recent Senate committee hearings by PMG Potter to the contrary", I would direct you to my responses to GCA/USPS-T7-11(a) and ABA&NAPM/USPS-T7-2 and to Maura Robinson's response to GCA/USPS-T1-1.

Figure 6. - Postal Rate Case Own Price Elasticity of Demand Single Piece, Work
Share, & Total First Class Mail Letters



RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

GCA/USPS-T7-12.

Please refer to your response to interrogatory GCA/USPS-T-7-11(a) and Exhibit A which was provided in that interrogatory. In your response you stated that "removing those rate changes which took place prior..., there appears to me to be no evidence of any discernable trend..."

- a) Please confirm that on Exhibit A there is a "discernable" pattern in elasticities for Single-Piece and Workshare, between the R97-1 and R2005-1 rate cases.
- b) Do the new variables such as employment, declining employment time trend, and Internet experience variables, explain why the elasticity for Single-Piece has drastically dropped since R2001-1 and for workshared has risen significantly? If your answer is "yes", please fully explain why. If your answer is "no", please explain in detail what factor(s) are causing these shifts and increasing divergence between the two FCLM mailstreams.
- c) Please refer to the Exhibit A. While you as a USPS witness on demand equation estimations "...have never provided any testimony regarding price elasticity,..." please explain what factor(s) may have caused over the R76-1 to R2005-1 rate cases a "discernable" downward trend in FCLM in USPS-sponsored rate case elasticity research.

RESPONSE:

- a. Not to be argumentative, but I really don't see it.
- b. Yes. Please see my response to ABA&NAPM/USPS-T7-2.
- c. The First-Class letters demand equation used by the Postal Service in R76-1 is beyond the scope of my testimony. My testimony did not consider the demand for First-Class letters prior to 1983.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

GCA/USPS-T7-13.

Please refer to the table for the unit root tests you provided in your response to GCA/USPS-T7-3.d.

- a) Please confirm that for Single-Piece and workshared FCLM, there is unquestionable evidence of non-stationarity under all three unit root tests, "Constant and Trend," "Constant and no Trend," and "no Constant no Trend."
- b) Please confirm whether your non-stationary dependent variable (volume for single-piece or volume for workshared) and a time trend variable you have included for employment would lead to spurious results. If confirmed, explain how this might have affected your results with respect to (i) the R-squared; (ii) the estimated coefficients; (iii) the coefficients' standard error of estimates; (iv) the t-tests. If not confirmed, please explain why.
- c) Please confirm whether your non-stationary dependent variable (volume for single-piece or volume for workshared) and the employment variable would lead to spurious results. If confirmed, explain how this might have affected the results with respect to (i) the R-squared; (ii) the estimated coefficients; (iii) the coefficients' standard error of estimates; (iv) the t-tests. If not confirmed, please explain why.

RESPONSE:

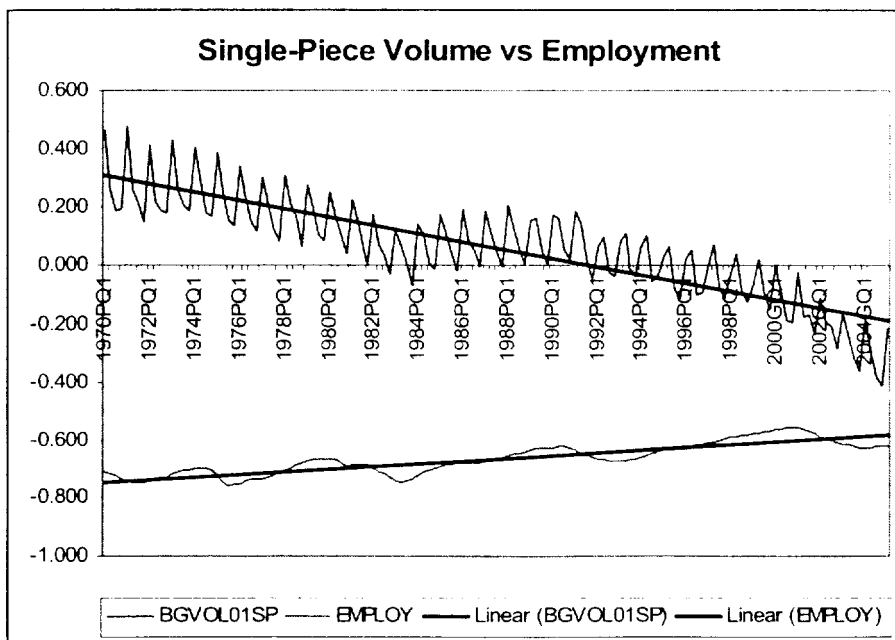
- a. Not confirmed. The null hypothesis of the Dickey-Fuller tests which were provided in response to GCA/USPS-T7-3(d) is the presence of unit roots (i.e., that the data are not stationary). In the cases of First-Class single-piece and workshared letters, the test statistics exceeded the critical values for all six tests presented. In each of these cases, this means that the null hypothesis – i.e., the existence of unit roots– can be rejected with 95 percent confidence. That is, the Dickey-Fuller tests presented in response to GCA/USPS-T7-3(d) provide evidence that these mail volumes are stationary.
- b. Not confirmed. As explained in my response to part a. above, First-Class letters volumes are stationary.
- c. Not confirmed. See my responses to parts a. and b.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO INTERROGATORIES OF GCA

GCA/USPS-T7-14.

Please refer to your LR-K-64, file R2005data.xls worksheet Eviews.

- a) Please confirm that this worksheet provides all the data that was used in your estimation after all adjustments and log transformations.
- b) Please confirm that using data in this worksheet and calculating the correlation between single piece volume (BGVOL01SP) and employment variable (EMPLOY) yields a value of 0.676. If not confirmed, please provide the correct correlation for these two variables.
- c) Please confirm that the correlation value given in part (b) is high enough to infer it is due to trends in these two variables that it should be a concern with respect to spurious results in the econometric estimation of the model. If not confirmed, please explain the theoretical and empirical rationale that this is not a spurious result.
- d) Please confirm that the following graph based on your own data from the Eviews worksheet referenced above is correct.



- e) Given the information in parts (b) - (d), can you still confirm that including the employment variable in your model would not result in spurious results. If confirmed, please provide textbook evidence to prove that it is not spurious (academic citations, mathematical prove, econometric, numerical, or any other proves). If not confirmed, please explain whether your estimation results for demand elasticities, in light of the apparent spurious nature of some of your

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

variables and your response to GCA/USPS-T7-3.c, would make sense and are econometrically correct.

RESPONSE:

a. Confirmed.

b. By my calculation, the simple correlation between BGVOL01SP and EMPLOY using all of the data presented in R2005Data.xls is -0.676. However, the First-Class single-piece letters demand equation presented in my testimony uses a sample period of 1983Q1 – 2005Q1 and models First-Class single-piece letters volume as a function of employment lagged one quarter. The simple correlation between BGVOL01SP and EMPLOY, lagged one quarter, from 1983Q1 through 2005Q1 is -0.497.

c. Not confirmed. It is certainly true that mis-specifying a demand equation can lead to spurious results and this problem can be particularly true when an explanatory variable shares a common trend with the dependent variable of interest despite a lack of a theoretical basis for viewing this relationship as causal. This is not true, however, in this case.

First, the theoretical basis for expecting a causal relationship between the United States economy and First-Class Mail volume is quite strong and should be obvious. The specific use of total private employment as the variable which is used to measure this relationship in the single-piece First-Class letters equation was discussed in my testimony at page 22, line 21, through page 23, line 7, which was quoted and expanded upon in my response to your earlier interrogatory, GCA/USPS-T7-1.

Second, as is made quite obvious in the graph which you helpfully provide here, the “common” trend in single-piece First-Class letters volume and total private employment (both per adult) is clearly negative. Hence, to the extent that this common trend could lead to “spurious” results, it seems clear to me that one would expect such a “spurious”

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

elasticity estimate to be negative. But, of course, the observed coefficient in this case is positive (0.673 with a t-statistic of 5.794).

Finally, then, following up on my second point, the significant positive coefficient on employment in the single-piece First-Class letters equation presented in my testimony is, in fact, clear and compelling evidence that the relationship between single-piece First-Class letters volume and private employment goes well beyond them simply sharing a common trend. In fact, if one compares the change in single-piece First-Class letters volume and employment relative to the same period the previous year (that is, compared $BGVOL01SP - BGVOL01SP$, lagged four quarters, with $EMPLOY(-1) - EMPLOY(-1)$, lagged four quarters), one would find that (a) the correlation between these two variables is strong and positive (simple correlation coefficient of 0.435), and (b) neither of the resulting variables possesses an obvious trend.

Taking all of this evidence into account, therefore, I am quite confident that the observed relationship between single-piece First-Class letters volume and employment presented and discussed in my testimony is not "spurious."

d. I am willing to assume that this graph accurately portrays what it purports to portray.

e. Confirmed. Please see my response to part c. above. I do not believe that any of my results could properly be characterized as "spurious."

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF GCA

GCA/USPS-T7-15.

Please refer to your response to GCA/USPS-T7-3.a. In your response, you have stated that, "It is sufficient condition, therefore, to have stationary dependent variables."

- a) Please confirm that your answer implies that only the dependent variable has to be stationary and that the independent variables do not necessarily have to be stationary. If confirmed, please provide citations from econometric texts to justify your answer. If not confirmed, please explain how you used "Generalized Least Squares."
- b) Please confirm that none of the variables you have used in your estimation are first-differenced or are de-trended.

RESPONSE:

a. Not confirmed. Actually, my response does not imply that the dependent variable "has to be stationary," only that it is a sufficient condition, although this may arguably be a bit of an over-statement. With respect to stationarity, Generalized Least Squares will produce the best, linear, unbiased coefficient estimates so long as the regression residuals are stationary. As I stated in my response to GCA/USPS-T7-3(e), Dickey-Fuller tests on the residuals from my regressions indicate the presence of no unit roots. Hence, the necessary stationary conditions for Generalized Least Squares are satisfied for every demand equation presented in my testimony.

b. Confirmed.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF VAL-PAK

VP/USPS-T7-1.

- a. Please refer to your testimony at Table 1 (USPS-T-7, p. 9). Please confirm that Table 1 indicates that the Postal own-price elasticity of Standard (Commercial) ECR mail is estimated to be -1.093. If you do not confirm, please provide the correct figure for own-price elasticity.
- b. Please refer to your testimony (USPS-T-8) in Docket No. R2001-1. Please confirm that the Postal own-price elasticity of Standard (Commercial) ECR mail was estimated to be -0.770 in Docket No. R2001-1 (USPS-T-8, p. 50, ll. 16-17). If you do not confirm, please provide the correct figure for own-price elasticity.
- c. If the amounts for the Postal own-price elasticity of Standard (Commercial) ECR mail in parts a and b are correct, please confirm that the Postal own-price elasticity of Standard (Commercial) ECR mail in the current docket represents approximately a 41.9 percent increase over the amount indicated in Docket No. R2001-1. Otherwise, please provide the correct percentage increase.

RESPONSE

- a. Confirmed.
- b. Confirmed
- c. Confirmed that the number 1.093 is 41.9 percent greater than the number 0.770.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF VAL-PAK

VP/USPS-T7-2.

- a. Please refer to your testimony at Table 1 (USPS-T-7, p. 9). Please confirm that Table 1 indicates that the Postal own-price elasticity of Standard (Commercial) Regular mail is estimated to be -0.267. If you do not confirm, please provide the correct figure for own-price elasticity.
- b. Please refer to your testimony (USPS-T-8) in Docket No. R2001-1. Please confirm that the Postal own-price elasticity of Standard (Commercial) Regular mail was estimated to be -0.388 in Docket No. R2001-1 (USPS-T-8, p. 49, ll. 9-10). If you do not confirm, please provide the correct figure for own-price elasticity.
- c. If the amounts for the Postal own-price elasticity of Standard (Commercial) Regular mail in parts a and b are correct, please confirm that the Postal own-price elasticity of Standard (Commercial) Regular mail in the current docket represents approximately a 31.2 percent decrease from the amount indicated in Docket No. R2001-1. Otherwise, please provide the correct percentage decrease.

RESPONSE

- a. Confirmed.
- b. Confirmed
- c. Confirmed that the number 0.267 is 31.2 percent less than the number 0.388.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF VAL-PAK

VP/USPS-T7-3.

- a. Please refer to your testimony at Table 1 (USPS-T-7, p. 9). Please confirm that Table 1 indicates that the Postal own-price elasticity of Standard bulk nonprofit mail (including both the Standard Nonprofit Regular and Standard Nonprofit ECR subclasses) is estimated to be -0.319. If you do not confirm, please provide the correct figure for own-price elasticity.
- b. Please refer to your testimony (USPS-T-8) in Docket No. R2001-1. Please confirm that the Postal own-price elasticity of Standard bulk nonprofit mail (including both the Standard Nonprofit Regular and Standard Nonprofit ECR subclasses) was estimated to be -0.230 in Docket No. R2001-1 (USPS-T-8, p. 51, ll. 17-18). If you do not confirm, please provide the correct figure for own-price elasticity.
- c. If the amounts for the Postal own-price elasticity of Standard Nonprofit ECR mail and Standard Nonprofit Regular mail in parts a and b are correct, please confirm that the Postal own-price elasticity of Standard Nonprofit Regular mail and Standard Nonprofit ECR mail in the current docket represents approximately a 38.7 percent increase over the amount indicated in Docket No. R2001-1. Otherwise, please provide the correct percentage increase.

RESPONSE

- a. Confirmed.
- b. Confirmed
- c. Confirmed that the number 0.319 is 38.7 percent greater than the number 0.230.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF VAL-PAK

VP/USPS-T7-4.

a. Please refer to your testimony at Table 1 (USPS-T-7, p. 9). Please confirm that the following volumes for Standard (Commercial) ECR mail are correctly indicated in Table 1:

<u>Year</u>	<u>Volume</u> <u>(millions of pieces)</u>
Base Year 2004	30,345.448
Test Year 2006 (Before Rates)	33,328.906
Test Year 2006 (After Rates)	32,187.100

b. Please refer to your testimony (USPS-T-7) at page 100 (ll. 19-23) which states:

The Test Year before-rates volume for Standard ECR is 33,328.906 million pieces, a **9.8 percent increase** from GFY 2004. The Postal Service's proposed rates in this case are predicted to **reduce** the Test Year volume of Standard ECR mail by **3.4 percent**, for a Test Year after-rates volume forecast for Standard ECR mail of 32,187.100 million. [USPS-T-7, p. 100, ll. 19-23, emphasis added.]

Please confirm that the Postal Service's proposed rate increase for Standard (Commercial) ECR mail of 5.6 percent in the present case is predicted to result in lost volume of 1,141.806 million pieces (*i.e.*, 33,328.906 less 32,187.100), or a decrease of 3.4 percent, of Standard (Commercial) ECR mail in Test Year 2006.

c. The total volume of Standard (Commercial) ECR mail (see part a above) and Standard Nonprofit ECR mail for Test Year 2006 after-rates is as follows:

	<u>Volume</u> <u>(millions of pieces)</u>
Standard (Commercial) ECR	32,187.100
Standard Nonprofit ECR	3,128.857
Total	35,315.957

Witness Robinson (USPS-T-27), in Exhibit USPS-27B of her testimony, indicates that the contribution of Standard (Commercial) ECR mail and Standard Nonprofit ECR mail is \$3,575,995,000, or 10.13 cents per unit (*i.e.*, $\$3,575,995,000 / 35,315,957,000 = \0.1013 per unit).

Please confirm that the reduction in volume that you project of 1,141.806 million pieces of Standard (Commercial) ECR mail corresponds to a decrease of about \$115,616,081 in the contribution from Standard (Commercial) ECR mail from that lost volume. If you cannot confirm, please state the lost contribution

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF VAL-PAK

from this lost volume.

RESPONSE

- a. Confirmed.
- b. Confirmed
- c. Re-directed to Postal Service witness Maura Robinson.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF VAL-PAK

VP/USPS-T7-5.

a. Please refer to your testimony at Table 1 (USPS-T-7, p. 9). Please confirm that the following volumes for Standard (Commercial) Regular mail are correctly indicated in Table 1:

<u>Year</u>	<u>Volume (millions of pieces)</u>
Base Year 2004	50,776.236
Test Year 2006 (Before Rates)	56,985.773
Test Year 2006 (After Rates)	56,478.638

b. Please refer to your testimony (USPS-T-7) at page 94 (ll. 22-26), which states:

The Test Year before-rates volume for Standard Regular mail is 56,985.733 million pieces, a **12.2 percent increase** from GFY 2004. The Postal Service's proposed rates in this case are predicted to **reduce** the Test Year volume of Standard Regular mail by **0.9 percent**, for a Test Year after-rates volume forecast for Standard Regular mail of 56,478.638 million. [USPS-T-7, p. 94, ll. 22-26, emphasis added.]

Please confirm that it is estimated that the Postal Service's proposed rate increase for Standard (Commercial) Regular mail of 5.6 percent in the present case will result in a decrease of 507.135 million pieces of Standard (Commercial) Regular mail in Test Year 2006 (*i.e.*, 56,985.773 less 56,478.638).

c. The total volume of Standard (Commercial) Regular mail and Standard Nonprofit Regular mail for Test Year 2006 after-rates is as follows:

	<u>Volume (millions of pieces)</u>
Standard (Commercial) Regular	56,478.638
Standard Nonprofit Regular	12,289.469
Total	68,768.107

Witness Robinson (USPS-T-27), in Exhibit USPS-27B of her testimony, indicates that the contribution of Standard (Commercial) Regular mail and Standard Nonprofit Regular mail is \$5,434,229, or 7.9 cents per unit (*i.e.*, \$5,434,229,000 / 68,768,107,000 = \$0.079 per unit). Please confirm that the reduction in volume that you project of 507.135 million pieces of Standard (Commercial) Regular mail corresponds to a decrease of about \$40,075,085 in the contribution from Standard (Commercial) Regular mail. If you cannot confirm, please state the lost contribution from this lost volume.

RESPONSE OF POSTAL SERVICE WITNESS THRESS TO
INTERROGATORIES OF VAL-PAK

RESPONSE

- a. Confirmed.
- b. Confirmed
- c. Re-directed to Postal Service witness Maura Robinson.

1 MR. KOETTING: Mr. Chairman, before we do that, I
2 do want to mention one point. On the designated written
3 cross-examination, we, last evening, submitted a request for
4 calculation on the procedures with the designation of
5 subparts.

6 There are instances in which parties did designate
7 only a portion of Witness Thress's response to an
8 interrogatory. It's our understanding that whether or not
9 that practice is something that should be allowed, and
10 that's what our motion is seeking to clarify, even if it
11 were to be allowed, we would have the ability to
12 counterdesignate the entire response. We have done so in
13 every instance in which some party has designated only a
14 portion, so the packet now has complete answers for every
15 question that was designated, and we did that after
16 discussion with your general counsel to put the transcript
17 in the best order possible. So that's what the packet that
18 I am handing to the reporter now contains. I just want to
19 make sure that everyone was clear on --

20 CHAIRMAN OMAS: We're clear on that. All right.
21 Thank you, Mr. Koetting.

22 We now turn to those witnesses for whom cross-
23 examination has been requested. Mr. Tidwell, would you
24 please identify the next Postal Service witness so I can
25 swear her in, please?

1 MR. TIDWELL: With your indulgence, Mr. Chairman,
2 could we have just one minute, but it will be Maura
3 Robinson?

4 (Pause.)

5 CHAIRMAN OMAS: Would you please remain standing?
6 Whereupon,

7 MAURA ROBINSON

8 having been duly sworn, was called as a witness
9 and was examined and testified as follows:

10 CHAIRMAN OMAS: Please be seated.

11 (The document referred to was
12 marked for identification as
13 Exhibit No. USPS-T-27.)

14 DIRECT EXAMINATION

15 BY MR. TIDWELL:

16 Q Ms. Robinson, on the table before you in the
17 corner here are two copies of a document entitled the
18 "Direct Testimony of Maura Robinson on behalf of the United
19 States Postal Service." It has been designated for purposes
20 of this proceeding as USPS-T-27. Was that document prepared
21 by you or under your supervision?

22 A Yes, it was.

23 Q If you were to give the contents of that document
24 today as your oral testimony today, would it be the same?

25 A Yes, it would be.

1 MR. TIDWELL: Mr. Chairman, the Postal Service
2 moves into evidence the direct testimony of Maura Robinson.

3 CHAIRMAN OMAS: Is there any objection?

4 (No objection.)

5 CHAIRMAN OMAS: Hearing none, I will direct
6 counsel to provide the reporter with two copies of the
7 corrected direct testimony of Ms. Robinson. That testimony
8 is received into evidence. However, as is our practice, it
9 will not be transcribed.

10 (The document referred to,
11 previously identified as
12 Exhibit No. USPS-T-27 was
13 received in evidence.)

14 CHAIRMAN OMAS: Ms. Robinson, have you had the
15 opportunity to examine the packet of designated written
16 cross-examination that was made available to you in the
17 hearing room this morning?

18 THE WITNESS: Yes, I have.

19 CHAIRMAN OMAS: If the questions contained in that
20 packet were posed to you orally today, would your answers be
21 the same as those previously provided in writing?

22 THE WITNESS: Yes, they would be, with the
23 following exceptions. MMA/USPS-T-27-2, we substituted the
24 revision from June 27th. MMA/USPS-T-27-3, we substituted
25 the revision from June 27th. Val-Pak VP/USPS-T-27-22, on

1 the second page, there is a numbering error. You should
2 delete the number B on the first line and renumber the
3 following paragraphs: Renumber C on line 3 as B; D on line
4 6 as C; E on line 12 as D; F on line 18 as E. Those changes
5 have been made in the packets.

6 CHAIRMAN OMAS: Counsel, would you please provide
7 two copies of the corrected designated written cross-
8 examination of Witness Robinson to the reporter? That
9 material is received into evidence and is to be transcribed
10 into the record.

11 (The document referred to,
12 previously identified as
13 Exhibit No. USPS-T-27 was
14 received in evidence.)

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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Request of the United States Postal
Service for a Recommended Decision on
Changes in Rates of Postage and Fees for
Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS MAURA ROBINSON
(USPS-T-27)

<u>Party</u>	<u>Interrogatories</u>
American Bankers Association and National Association of Presort Mailers	ABA&NAPM/USPS-T27-1a-b, 2 MMA/USPS-T27-2a-b, e, 3a-b, e MMA/USPS-T28-1d redirected to T27
Greeting Card Association	GCA/USPS-T27-1 GCA/USPS-T1-1, 2a-b, e, h redirected to T27
Magazine Publishers of America	MMA/USPS-T28-1d redirected to T27 VP/USPS-T27-12, 14, 17, 19, 22
Major Mailers Association	MMA/USPS-T27-2-4
Newspaper Association of America	VP/USPS-T27-5-8, 14, 17 VP/USPS-T7-4c, 5c redirected to T27
Office of the Consumer Advocate	OCA/USPS-T27-1 OCA/USPS-T1-3 redirected to T27

PartyInterrogatories

Pitney Bowes Inc.

MMA/USPS-1 redirected to T27

MMA/USPS-T28-1d redirected to T27

PRC/USPS-POIR No.4- Q3c, POIR No.5- Q4c
redirected to T27

VP/USPS-T27-1, 5-9, 12-14, 17-19, 21-22

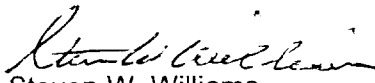
Valpak Direct Marketing Systems,
Inc. and Valpak Dealers' Association
Inc.

VP/USPS-T27-1-9, 11-15, 17-23

VP/USPS-T7-4c, 5c redirected to T27

VP/USPS-T28-17d, 18a-b, 21c, 28b-c redirected
to T27

Respectfully submitted,


Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS MAURA ROBINSON (T-27)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

Interrogatory

Designating Parties

ABA&NAPM/USPS-T27-1a	ABA&NAPM
ABA&NAPM/USPS-T27-1b	ABA&NAPM
ABA&NAPM/USPS-T27-2	ABA&NAPM
GCA/USPS-T27-1	GCA
GCA/USPS-T1-1 redirected to T27	GCA
GCA/USPS-T1-2a redirected to T27	GCA
GCA/USPS-T1-2b redirected to T27	GCA
GCA/USPS-T1-2e redirected to T27	GCA
GCA/USPS-T1-2h redirected to T27	GCA
MMA/USPS-T27-2	MMA
MMA/USPS-T27-2a	ABA&NAPM
MMA/USPS-T27-2b	ABA&NAPM
MMA/USPS-T27-2e	ABA&NAPM
MMA/USPS-T27-3	MMA
MMA/USPS-T27-3a	ABA&NAPM
MMA/USPS-T27-3b	ABA&NAPM
MMA/USPS-T27-3e	ABA&NAPM
MMA/USPS-T27-4	MMA
MMA/USPS-1 redirected to T27	Pitney Bowes
MMA/USPS-T28-1d redirected to T27	ABA&NAPM, MPA, Pitney Bowes
OCA/USPS-T27-1	OCA
OCA/USPS-T1-3 redirected to T27	OCA
PRC/USPS-POIR No.4- Q3c redirected to T27	Pitney Bowes
PRC/USPS-POIR No.5- Q4c redirected to T27	Pitney Bowes
VP/USPS-T27-1	Pitney Bowes, Valpak
VP/USPS-T27-2	Valpak
VP/USPS-T27-3	Valpak
VP/USPS-T27-4	Valpak
VP/USPS-T27-5	NAA, Pitney Bowes, Valpak
VP/USPS-T27-6	NAA, Pitney Bowes, Valpak
VP/USPS-T27-7	NAA, Pitney Bowes, Valpak
VP/USPS-T27-8	NAA, Pitney Bowes, Valpak

Interrogatory

VP/USPS-T27-9
 VP/USPS-T27-11
 VP/USPS-T27-12
 VP/USPS-T27-13
 VP/USPS-T27-14

 VP/USPS-T27-15
 VP/USPS-T27-17

 VP/USPS-T27-18
 VP/USPS-T27-19
 VP/USPS-T27-20
 VP/USPS-T27-21
 VP/USPS-T27-22
 VP/USPS-T27-23
 VP/USPS-T7-4c redirected to T27
 VP/USPS-T7-5c redirected to T27
 VP/USPS-T28-17d redirected to T27
 VP/USPS-T28-18a redirected to T27
 VP/USPS-T28-18b redirected to T27
 VP/USPS-T28-21c redirected to T27
 VP/USPS-T28-28b redirected to T27
 VP/USPS-T28-28c redirected to T27

Designating Parties

Pitney Bowes, Valpak
 Valpak
 MPA, Pitney Bowes, Valpak
 Pitney Bowes, Valpak
 MPA, NAA, Pitney Bowes,
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**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF ABA&NAPM**

ABA&NAPM/USPS-T27-1.

On page 6 of your testimony starting at line 9, you state "The escrow costs that underlie this request are not volume-variable and cannot be found to be "costs... attributable to ...[a] particular class of mail."

- a. In light of this, please confirm that it is not any intra-subclass volume variable cost, but only costs in general, both attributable and institutional, that matter for the rates proposed in this case.
- b. In light of the escrow rationale for this case, would it be appropriate to raise or lower any particular rate proposed within the structure of USPS "settlement rates" on the grounds that its particular volume variable costs did not justify the rate proposed?
- c. Were the Commission to raise any of the proposed settlement rates given the escrow rationale for the case, would the extra burden on that rate category be inequitable in that more costs would be borne by that rate category in helping meet a strictly non-class specific revenue need, i.e. the escrow?
- d. Were the Commission to lower any of the proposed settlement rates given the escrow rationale for the case, would the reduced burden on that rate category be inequitable in that fewer costs would be borne by that rate category in helping meet a strictly non-class specific revenue need, i.e. the escrow?

RESPONSE:

- a. Confirmed that the objective of this case is to recover the Congressionally-mandated escrow obligation (an institutional cost) through a 5.4 percent across-the-board increase in rates. Confirmed also that this proposal does not adjust rates based on changes in inter- or intra-class cost relationships with the exception of Registered Mail and Periodicals Applications Fees. For these two special services, a greater-than-average fee increase was proposed due to the section 3622(b)(3)

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF ABA&NAPM**

RESPONSE TO ABA&NAPM/USPS-T27-1 (continued):

requirement that rates and fees cover the attributable costs of providing the service.

b. No. The Postal Service is attempting to reach settlement based on the rates proposed in this case.

c. – d.

Under the ratemaking provisions of Title 39, the rates and fees recommended by the Commission must be “fair and equitable.” 39 USC 3622(b)(1). I expect that rates and fees recommended by the Commission will meet this requirement.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF ABA&NAPM**

ABA&NAPM/USPS-T27-2.

- a. Please confirm in your Exhibit USPS-27B that the cost coverage of 331.9% listed for First Class presort mail is the highest of any mail category for which you calculate a TY2006 cost coverage on that Exhibit.
- b. Please confirm that whether one uses the Postal Service's "cumulative passthrough percentages" or the Commission's "incremental passthrough percentages" on discounts relative to costs avoided for various rate categories for workshared FCLM, and whether or not you use the volume variability methodology of the Postal Service of the Commission, under your proposed rates for TY2006 the highest per piece cost contribution to the Postal Service's institutional costs of any mail category for which you calculate a TY2006 cost coverage in your Exhibit USPS-27B is First Class workshared mail.
- c. Please confirm that were any of the passthroughs for workshared FCLM to be reduced by the Commission in this case by raising any workshared FCLM rates beyond what you have proposed, the cost coverage for workshared FCLM would be even higher than your calculate 331.9.

RESPONSE:

- a. Confirmed. Please note that the cost coverage for Presorted and Automation First-Class Mail Letters is 331.8 percent. Revised Exhibit USPS-27B, filed June 10, 2005.
- b. Not confirmed. Presort and Automation First-Class Mail Letters has the highest test-year-after-rates cost coverage on a percentage basis for any rate category shown on Exhibit USPS-27B. As shown in the response to MMA/USPS-T27-1(b), this is also the case if Exhibit USPS-27B is recalculated using the Postal Rate Commission's costing methodology. However, on a dollars-per-piece basis, the cost coverage for several subclasses is higher than that of Presorted and Automation First-Class

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF ABA&NAPM**

RESPONSE TO ABA&NAPM/USPS-T27-2 (continued):

Mail Letters. For example, using the Postal Service costing methodology, the cost coverage measured in dollars-per-piece for Express Mail is \$7.81 as compared to the cost coverage in dollars-per-piece for Presorted and Automation First-Class Mail Letters of \$0.22. Exhibit USPS-27B (revised, filed June 10, 2005).

- c. Confirmed if (1) costs and cost avoidances were calculated using the same methodology and benchmarks as proposed by the Postal Service and (2) the Commission recommended the single-piece, first-ounce First-Class Mail rate proposed by the Postal Service, and (3) the Commission recommended all other rates (e.g., additional ounce rates) proposed by the Postal Service.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF GREETING CARD ASSOCIATION
Revised Again: June 27, 2005**

GCA/USPS-T27-1.

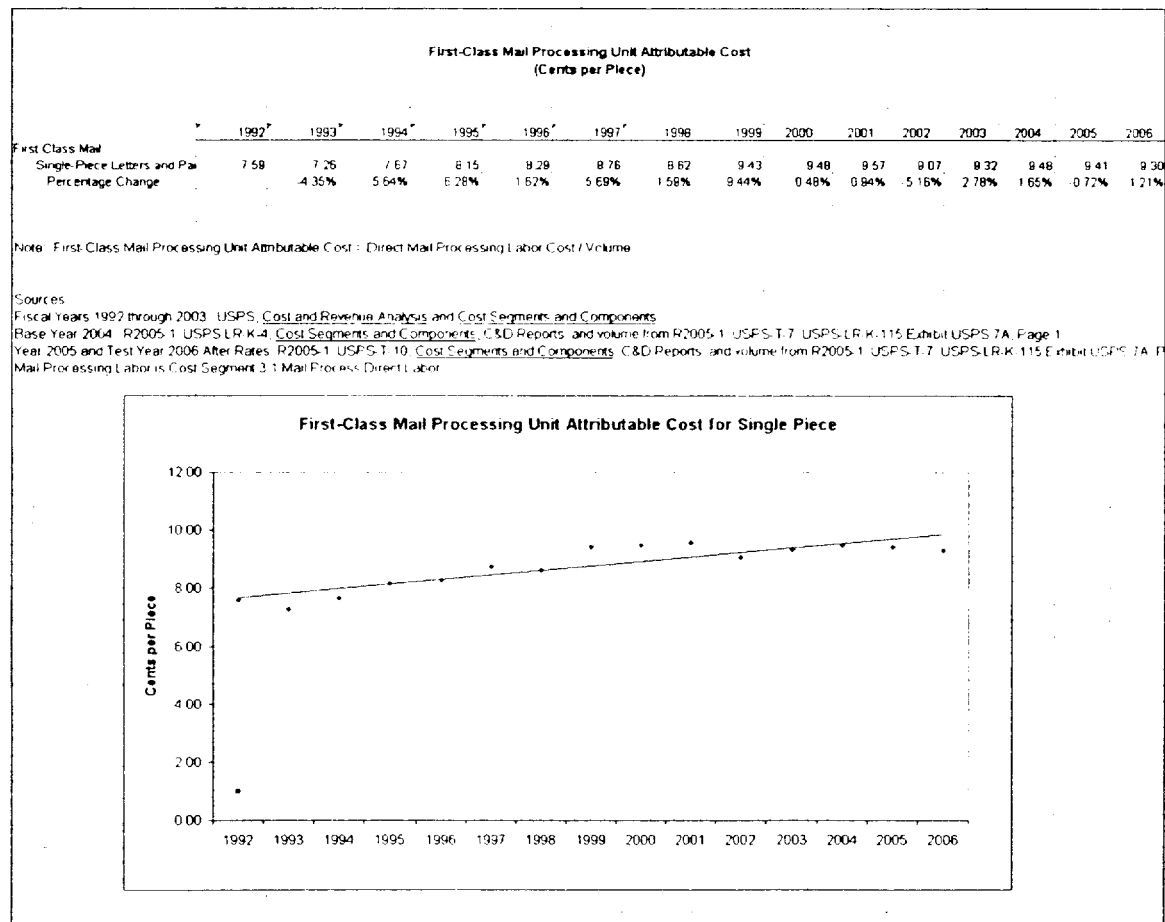
Please consider the chart attached below, which shows the history of CRA cost segment 3.1 direct unit costs for mail processing labor for First Class single piece mail. And for 2005 and 2006, adds estimates for those costs made by the Postal Service in this rate case.

- a. In a rate case in general, would the observed decline in the attachment in mail processing unit costs for single piece FCM be one factor you would consider in deciding on the rate for First Class single piece letter mail?
- b. In this rate case, did you take the observed trend in the attachment into account in any way in proposing the First Class single piece rate?
- c. In this rate case, were you aware of the trend observed in the attachment when you settled upon your 39 cent proposed rate?
- d. In the next rate case, if any, assuming the observed trend were to be realized, is that a factor you would take into consideration in proposing a rate for single piece First Class letters?

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF GREETING CARD ASSOCIATION**

Revised Again: June 27, 2005

GCA/USPS-T27-1 (continued):



RESPONSE:

- a. Yes, relative changes in costs for a subclass or rate category are considered in rate cases, in general.
- b. — c.

I was aware of the trends in mail processing costs for First-Class Mail when the 39-cent proposed rate for single-piece First-Class Mail weighing one ounce or less was developed. However, as discussed in my testimony, in this case, the Postal Service is proposing a 5.4 percent,

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF GREETING CARD ASSOCIATION**

Revised Again: June 27, 2005

RESPONSE to GCA/USPS-T27-1 (continued):

across-the-board rate increase for the sole purpose of recovering the Congressionally-mandated escrow requirement. Because the escrow requirement is not affected by mail processing costs for single-piece, First-Class Letters, changes in these costs were not used to adjust this rate proposal.

- d. Yes, trends in mail processing costs for First-Class Mail – both single-piece and presorted -- will be considered when rates are proposed in a future docket.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

GCA/USPS-T1-1. In your testimony at page 2, starting at line 18, you state “We currently face serious economic and operational challenges. The need to raise rates prematurely for any reason will not help us meet them, and will burden our customers and the economy.” In the same manner, you stated publicly and in greater detail at recent Senate Committee hearings on postal reform: “Electronic diversion continues to erode First-Class Mail volume, this product will become more price-sensitive than ever. Higher rates will likely increase the pace of change, accelerating the volume decline, resulting in falling revenue . . .”.

- a. Do you understand your statement at the Senate Committee hearings on postal reform to be what economists call a situation of absolute own price elasticity with a value greater than the absolute value of -1?
- b. Why is the Postal Service proposing to raise rates at all for FCM in this case if it believes the lost volume from the increase will reduce, rather than raise, revenue for the Postal Service?
- c. Do you agree that USPS witness Thress and you cannot both be correct in assessing the true value of the own price elasticity for the FCLM subclass?
- d. How do you reconcile your statement above at the Senate Committee hearings on postal reform with the “rate case elasticity” submitted by USPS witness Thress in this case, which shows an own price elasticity for FCM below the absolute value of -1, albeit higher than the relatively inelastic rate case elasticity for FCM that he submitted in last rate case?
- e. Is your statement at the Senate Committee hearings on postal reform and in your testimony as referenced above one of the reasons the Postal Service considered phased rates preparatory to filing this case, i.e. to avoid a highly publicized double digit increase in the face of increasingly elastic demand conditions in FCM?
- f. Are there other elasticity perspectives than those proffered by rate case witnesses of which you or any staff advising you are aware which have helped inform your opinion of the issues? If so, please provide all such materials, including, but not limited to, materials developed under the direction of Margaret Crenshaw within the USPS or any individuals or groups outside USPS, other internal source(s) or external source(s).

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

RESPONSE to GCA/USPS-T1-1:

In his April 14, 2005 testimony before the Senate Committee on Homeland Security and Governmental Affairs, witness Potter was not discussing the empirical estimation of own-price elasticities. Witness Potter testified on the Postal Service's long-term financial and operational outlook. These concerns are not solely focused on FY 2006 (the test year in this docket) but rather look at the longer term. I see no inherent contradiction with the fact that a measured price increase may produce a net increase in contribution and the concern that raising prices is not always the preferred or optimal solution for every given circumstance. In this instance, the Postal Service believes a measured across-the-board increase is the most appropriate means to meet the escrow requirement. However, the long-term viability of almost any organization is not its ability to unilaterally raise prices. Instead, it is the ability of the organization to provide the products or services its customers or constituents need at reasonable prices.

- a. Holding all else constant, if the own-price elasticity for a product is greater than one in absolute value, then total revenue will decrease if the price of the product increases. However, the cited section of witness Potter's Senate testimony does not discuss a circumstance where all else is held constant. Witness Potter discusses a scenario where electronic diversion reduces the demand (shifts the demand curve) for First-Class Mail. This

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

RESPONSE to GCA/USPS-T1-1 (continued):

scenario may be associated with, for instance, changes in the actual or perceived substitutability of electronic messages for First-Class Mail. This effect is modeled by witness Thress who states “

The Internet has had a very strong negative effect on First-Class single-piece letters volume, explaining annual losses that have averaged 4 percent per year for nearly a decade.

USPS-T-7 at 55. Even with the consideration of the effect of electronic diversion as measured by witness Thress, the estimated test-year elasticity of demand for First-Class Mail is less than one in absolute value.

- b. As shown in Exhibit USPS-27A and Exhibit USPS-27B, I do not believe that the proposed increase in First-Class Mail rates will reduce revenue for the Postal Service. Test-year revenues from First-Class Mail are projected to increase by \$1.4 billion. This projected revenue increase incorporates the volume reduction that occurs as a result of the proposed increase in rates.
- c. See the response to (a) above. In addition, witness Potter's Senate testimony focuses on a longer period than does witness Thress's testimony.

Witness Potter's Senate testimony discusses the long term performance of the Postal Service beginning with postal reorganization and focusing on the Postal Service's success in addressing more recent concerns expressed by the General Accountability Office, Congress and others. He

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

RESPONSE to GCA/USPS-T1-1 (continued):

specifically notes “[t]he future of America’s postal system, however, will depend on much more than the next rate case” and continues to discuss long term planning initiatives including the Strategic Transformation Plan 2006-2010. On the other hand, witness Thress’s testimony including the elasticity estimates are focused on the test year.

- d. See the response to part (c).
- e. As discussed in the Postal Service’s testimony, in this docket, witness Potter determined that the escrow requirement could be best met through an across-the-board rate request, not a “phased rate increase” or any other possible rate proposal.
- f. The only estimates of elasticity relied upon in the preparation of this rate case were those provided by witness Thress in his testimony. I have been unable to locate any other elasticity estimates prepared “within the USPS or [by] any individuals or groups outside USPS, other internal source(s) or external sources(s)” for the Postal Service.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

Revised: June 22, 2005

GCA/USPS-T1-2. In your testimony at page 2, starting at line 18, you state "We currently face serious economic and operational challenges. The need to raise rates prematurely for any reason will not help us meet them, and will burden our customers and the economy." In the same manner, you stated publicly and in greater detail at recent Senate Committee hearings on postal reform: "Declining First-Class Mail volume, coupled with a market shift from higher-margin to lower margin products, will result in insufficient revenue to support our infrastructure and the costs of an ever-expanding delivery network." In a letter to Sen. Susan Collins dated February 24, 2005, USPS Board of Governors, Chairman James C. Miller III stated: "On the other hand, the Service faces significant challenges. Its decades-old business model, in which a continually-growing First-Class Mail volume with its large per-piece contribution defrays the major portion of infrastructure costs, is no longer valid."

- a. Are your statements consistent with that of Chairman Miller? If your answer is not an unqualified "yes," please explain.
- b. Please state specifically what "lower-margin products" you are referring to by subclass.
- c. Combined with your statement about increasing elasticities in FCM, isn't the inevitable conclusion of the points made above that today's lower margin volume drivers for the Postal Service will have to have larger per-piece contributions than at present, while FCM will have to have lower per-piece contributions than at present? Please explain fully your answer.
- d. Do you agree that the proposed across the board rate increase in this case, whatever its merits on other grounds, does not address the relative rate issues implied by the above statements?
- e. When does the Postal Service plan on starting to address the relative per-piece contribution issues raised in the above statements insofar as rate setting is concerned?
- f. Would you agree that if per piece contributions are lowered for FCM, and raised for Standard, some Standard mail that is price inelastic may migrate to FCM, thus helping to ameliorate the current decline in FCM volume?
- g. Is rapid growth from targeted advertising FCM at relatively higher per piece contributions to overhead, albeit lower than current, combined with higher-than-current per-piece contributions from advertising mail that remains in the Standard Class the most likely new business model that the USPS will need to adopt to remain financially viable? Please explain fully your answer.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

Revised: June 22, 2005

GCA/USPS-T1-2 (continued):

- h. Was any costs benefit test applied to the question whether the costs of avoiding the issues raised in a. through g., above, were worth the benefits of an across-the-board revenue raising initiative that does not address those issues? If your answer is not an unqualified "no," please describe that test fully and state the conclusions it yielded.

RESPONSE:

- a. Yes. I believe the statements of witness Potter and Chairman Miller are consistent.
- b. The context of the quote suggests that witness Potter was discussing products with lower cost coverages ("lower margins") than the First-Class Mail Letters and Sealed Parcels subclass. The estimated test-year-after-rates cost coverage for the First-Class Mail Letters and Sealed Parcels subclass is 229.8 percent. All other subclasses with the exception of Standard Mail Enhanced Carrier Route have lower cost coverages. Exhibit USPS-27B. While I do not believe that any subclass would be exempted from a future rate increase, the volume growth of Standard Mail Regular in contrast to the decline in First-Class Mail Letters would suggest that this subclass might be one possible source of additional contribution.
- c. No. The quoted statement suggests that the decline in First-Class Mail Letters volume and the possible resulting decline in total contribution from this subclass will need to be offset. However, I cannot reach the conclusion that First-Class Mail Letters subclass per-piece contribution will necessarily decline, it may remain constant or even increase somewhat

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

Revised: June 22, 2005

RESPONSE to GCA/USPS-T1-2 (continued):

depending on the Postal Service's evaluation of the circumstances surrounding a future rate request. In addition, while larger per-piece contributions may be necessary from other subclasses, the need for any such increases may be, in part, offset by volume growth.

d. Yes.

e. The Postal Service considers the full context in which pricing decisions are made and develops a pricing proposal that meets its revenue requirement and that is consistent with the pricing criteria and other statutory requirements of the Postal Reorganization Act. While the structure of future rate proposals is unknown, I expect that the Postal Service will consider all relevant factors, including those discussed in the testimony of witness Potter and Chairman Miller in formulating its next rate request.

f. No. Migration between Standard Mail and First-Class Mail would depend on the relative prices of those products not the absolute per-piece contribution. For example, it is possible that per-piece contribution for First-Class Mail could decrease, per-piece contribution for Standard Mail could increase and the actual prices for each of these products would be the same.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF GREETING CARD ASSOCIATION
REDIRECTED FROM WITNESS POTTER**

Revised: June 22, 2005

RESPONSE to GCA/USPS-T1-2 (continued):

- g. I do not know. It is unclear what hypothetical you are describing. This question assumes future rates, rate relationships and changes that are outside the scope of this docket.
- h. No. The Postal Service did, however, evaluate this proposal within the context of the nine pricing criteria and the unique circumstances surrounding the escrow requirement as described in my responses to VP/USPS-T27-1c and VP/USPS-T27-9e.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION
Revised: June 27, 2005**

MMA/USPS-T27-2

Please refer to your response to Interrogatory MMA/USPS-T27-1 B where you provide TY 2006 postal finances using the Commission's attributable cost methodology.

- A. Please confirm that, in R2000-1 and R2001-1, the Postal Rate Commission recommended rates for First-Class letters that resulted in cost coverages of 179 and 192, respectively. If you cannot confirm, please provide the correct cost coverages, explain how they were derived, and provide complete references to all source materials used.
- B. Please confirm that the Postal Service's proposed rates in R2005-1 result in a cost coverage for First-Class letters equal to 218. If you cannot confirm, please provide the correct cost coverage, explain how it was derived, and provide complete references to all source materials used.
- C. Please confirm that, in R2000-1 and R2001-1, the Postal Rate Commission recommended rates for First-Class letters that reflected markup indices of 138 and 145, respectively. If you cannot confirm, please provide the correct markup indices, explain how they were derived, and provide complete references to all sources used.
- D. Please confirm that the Postal Service's proposed rates in R2005-1 result in a markup index for First-Class letters equal to 148. If you cannot confirm, please provide the correct markup index, explain how it was derived, and provide complete references to all sources used.
- E. Please explain why the Postal Service's proposed 5.4% across-the-board rate increase significantly raises the cost coverage and markup index for First-Class mail in this case.

RESPONSE

- A. Confirmed. See the Attachment to MMA/USPS-T27-2, columns (1) and (2).
- B. Confirmed assuming the Postal Rate Commission costing methodology is used. See the Attachment to MMA/USPS-T27-2, column (3).

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION
Revised: June 27, 2005**

RESPONSE TO MMA/USPS-T27-2 (continued):

- C. Not confirmed. The markup index for First-Class Mail Letters and Sealed Parcels subclass for the Commission's recommended rates was 1.342 in Docket No. R2000-1 and 1.420 in Docket No. R2001-1. See Docket No. R2001-1, PRC Op. Appendix G at 37 and the Attachment to MMA/USPS-T27-2, column (1) and (2).
- D. Not confirmed. In this case, for the First-Class Mail Letters and Sealed Parcels subclass, the Postal Service's rate proposal results in a markup index of 1.450 using the Postal Service's costing methodology and 1.497 using the Postal Rate Commission's costing methodology. See the Attachment to MMA/USPS-T27-2 columns (3) [PRC] and (4) [USPS]
- E. The increase in the markup index for First-Class Mail Letters is not caused by the across-the-board proposed rate increase. In the absence of other changes in costs, an across-the-board rate increase will cause the markup indices for the individual subclasses to move towards the average markup index for the postal system as a whole.

While the increase in the cost coverage for First-Class Mail is, in part, driven by the across-the-board rate increase proposed in this case, this is not the sole reason for the increase. The increases in both the cost coverage and the markup index for First-Class Mail Letters are in large measure the result of successful efforts to control Postal Service costs and may also be affected by changes in the characteristics of First-Class

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION
Revised: June 27, 2005**

RESPONSE TO MMA/USPS-T27-2 (continued):

Mail Letters. One result of the successful efficiency efforts is that, if the escrow obligation did not exist, the Postal Service would have been able to forgo a rate increase at this time. Instead, as discussed by witness Potter, the sole reason this increase has been proposed is to recover the Congressionally-mandated escrow obligation.

Attachment to MMA/USPS-T27-2 REVISED 6/27/2005
Calculation of Markups and Markup Indices
Dockets No. R2000-1, R2001-1 and R2005-1

		R2000-1	R2001-1	R2005-1	R2005-1
	Costing Methodology	PRC	PRC	PRC	USPS
		(1)	(2)	(3)	(4)
First-Class Mail Letters and Sealed Parcels					
(a)	Revenue	35,749,605	37,781,209	35,901,564	35,901,564
(b)	Costs	19,989,490	19,677,353	16,453,261	15,621,298
(c) = [(a) / (b)]	Cost Coverage	178.8%	192.0%	218.2%	229.8%
(d) = [(a) / (b)] - 1	Markup	78.8%	92.0%	118.2%	129.8%

First-Class Mail Presorted and Automation Letters

(e)	Revenue	13,172,716	15,915,988	15,382,830	15,382,830
(f)	Costs	5,305,138	5,985,539	4,912,741	4,636,166
(g) = [(e) / (f)]	Implicit Cost Coverage	248.3%	265.9%	313.1%	331.8%
(h) = [(e) / (f)] - 1	Implicit Markup	148.3%	165.9%	213.1%	231.8%

All Mail and Services

(i)	Revenue	68,789,970	74,741,743	72,463,782	72,463,782
(j)	Costs	43,336,799	45,361,242	40,486,419	38,236,154
(k) = [(i) / (j)]	Cost Coverage	158.7%	164.8%	179.0%	189.5%
(l) = [(i) / (j)] - 1	Markup	58.7%	64.8%	79.0%	89.5%

(m) = (d) / (l)	Markup index FCM Letters	1.342	1.420	1.497	1.450
(n) = (h) / (l)	Implicit Markup index presort FCM Letters	2.525	2.561	2.698	2.589

<u>Sources</u>	(1)	(2)	(3)	(4)
(a) App. G at 1	App. G at 1	App. G at 1	Exhibit USPS-27B*	Exhibit USPS-27B*
(b) App. G at 1	App. G at 1	App. G at 1	MMA/USPS-T27-1B	Exhibit USPS-27B*
(e) App. G at 2	App. G at 2	App. G at 2	Exhibit USPS-27B*	Exhibit USPS-27B*
(f) App. J at 1	App. F at 1	App. F at 1	MMA/USPS-T27-1B	Exhibit USPS-27B*
(i) App. G at 1	App. G at 1	App. G at 1	Exhibit USPS-27B*	Exhibit USPS-27B*
(j) App. G at 1	App. G at 1	App. G at 1	MMA/USPS-T27-1B	Exhibit USPS-27B*

* Revised 6/10/2005

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION
Revised: June 27, 2005**

MMA/USPS-T27-3

Please refer to your response to Interrogatory MMA/USPS-T27-1 B where you provide TY 2006 postal finances using the Commission's attributable cost methodology. Please also refer to USPS witness Taufique's response to Interrogatory GCA/USPS-T28-1 where he states, in relevant part:

...although workshared First-Class Mail is not a subclass, the proposal along the lines suggested in your question would cause these workshare rate categories, which have an implicit cost coverage exceeding all of the subclasses and whose unit cost has in fact declined 2.8 percent (between FY2000 and FY2004), to bear a disproportionate share of the escrow burden.

- A. Please confirm that, in R2000-1 and R2001-1, the Postal Rate Commission recommended rates for First-Class workshared letters that resulted in implicit cost coverages of 248 and 266 for, respectively. If you cannot confirm, please provide the correct cost coverages, explain how they were derived, and provide complete references to all source materials used.
- B. Please confirm that, in R2005-1, the Postal Service's proposed rates for First-Class workshared letters result in an implicit cost coverage equal to 313. If you cannot confirm, please provide the correct cost coverage, explain how it was derived, and provide complete references to all source materials used.
- C. Please confirm that, in R2000-1 and R2001-1, the Postal Rate Commission recommended rates for First-Class workshared letters that resulted in implicit markup indices of 260 and 261, respectively. If you cannot confirm, please provide the correct markup indices, explain how they were derived, and provide complete references to all source materials used.
- D. Please confirm that, in R2005-1, the Postal Service has proposed rates for First-Class workshared letters that result in an implicit markup index equal to 267. If you cannot confirm, please provide the correct markup index, explain how it was derived, and provide complete references to all sources used.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION
Revised: June 27, 2005**

MMA/USPS-T27-3 (continued):

- E. Please confirm that, according to USPS witness Abdirhaman's workshare R2005-1 cost savings analysis (as shown in LR-USPS-K-47), the Postal Service's proposed discounts for First Class workshared letters allegedly exceed the purported cost savings. If you cannot confirm, please provide the correct discounts and related cost savings, explain how they were derived, and provide complete references to all source materials used.
- F. Please explain why, in spite of increased discounts for First Class workshared letters that allegedly exceed the purported cost savings, the Postal Service's proposed 5.4% across-the-board rate increase in R2005-1 would result in significant increases in the implicit cost coverage and implicit markup index for such workshared mail.

RESPONSE

- A. Confirmed. See the Attachment to MMA/USPS-T27-2, column (1) and (2).
- B. Confirmed assuming the Postal Rate Commission costing methodology is used. See Attachment to MMA/USPS-T27-2 column (3).
- C. Not confirmed. In Docket No. R2000-1, the Postal Rate Commission recommended an implicit markup for First-Class Mail Presorted and Automation Letters and Sealed Parcels of 2.525. In Docket No R2001-1, the Postal Rate Commission recommended an implicit markup for First-Class Mail Presorted and Automation Letters and Sealed Parcels of 2.561. See the Attachment to MMA/USPS-T27-2 columns (1) and (2).
- D. Not confirmed. In this case, for the First-Class Mail Presorted and Automation Letters and Sealed Parcels subclass, the Postal Service's rate proposal results in an implicit markup index of 2.589 using the Postal Service's costing methodology and 2.698 using the Postal Rate

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION
Revised: June 27, 2005**

RESPONSE TO MMA/USPS-T27-3 (continued):

Commission's costing methodology. See the Attachment to MMA/USPS-T27-

2 columns (3) [PRC] and (4) [USPS]

E. Confirmed.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION**

MMA/USPS-T27-4

Please refer to your response to Interrogatory MMA/USPS-T27-1 B where you provide TY 2006 postal finances using the Commission's attributable cost methodology. Please also refer to page 9 of USPS witness Thress' direct testimony where he provides estimated price elasticities for various categories of mail.

- A. Please confirm that, according to USPS witness Thress, the own price elasticity for First-Class workshared letters has increased dramatically from -0.071 in R2001-1 (USPS-T-8, p. 22) to -0.329 in R2005-1. If you cannot confirm, please explain.
- B. Please confirm that, according to USPS witness Thress, the own price elasticity of -0.329 for First-Class workshared letters is now higher than the own price elasticity of -0.267 for standard regular letters. If you cannot confirm, please explain.
- C. Please explain how you took into consideration the own price elasticity for workshared letters, which has more than quadrupled, when determining that the proposed 5.4% across-the-board rate increase, the resulting cost coverage, and the resulting markup index were all fair and equitable according to the standards established in Section 3622(B) of the Act.

RESPONSE:

- A. Confirmed that the estimated elasticity for First-Class Mail workshared letters in this docket is -0.329 and that this elasticity was estimated to be -0.071 in Docket No. R2001-1. For an explanation of First-Class Mail elasticity estimates, changes in elasticity, and how to interpret them, please see witness Thress's testimony, Section II.B.7, "Understanding First-Class Letters Price Elasticities" and witness Thress's response to ABA&NAPM/USPS-T7-2.
- B. Confirmed that the own-price elasticity of -0.329 for workshared First-Class Mail is greater in absolute value than the own-price elasticity of -0.267 for Standard Mail Regular subclass. But, for a fuller explanation,

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION**

RESPONSE TO MMA/USPS-T27-4 (continued):

please see the references to witness Thress's testimony cited in the response to part a above.

- C. As indicated by witness Thress in his response to ABA&NAPM/USPS-T7-2, a change in the estimated elasticity does not necessarily mean that the actual elasticity has changed. In preparing any rate proposal, the Postal Service reviews elasticity estimates as one measure of the economic value of service, indicating how the volume of a product customers purchases changes in response to a price change. Generally, the higher the elasticity in absolute value, the lower the economic value of service. A relatively low economic value of service would tend to support a lower markup that would a higher economic value of service. However, in addition to reviewing elasticity estimates, the Postal Service also reviews the intrinsic value of service to both the sender and the recipient. Elasticity estimates may not capture fully the value of service to the recipient which also must be considered under section 3622(b).

In preparing this proposal, I did review the relative value of service and the extent to which it was reflected in the current rates for workshared First-Class Mail. I also considered the circumstances surrounding the escrow obligation. On balance, given that the escrow requirement was

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION**

RESPONSE TO MMA/USPS-T27-4 (continued):

not a cost associated with the provision of mail services, the decision was made that an across-the-board increase to recover the escrow obligation was the most fair and equitable approach in this docket.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION**

MMA/USPS-1. Please refer to the response to Interrogatory MMA/USPS-T21-16 (redirected from USPS witness Abdirahman) where you discuss the relationship of PostalOne! cost savings with workshare cost savings. You state, in part,

While PostalOne! may facilitate worksharing, installation of PostalOne! in and of itself does not consist of "worksharing." "Worksharing" includes presortation, making mail automation compatible, and dropshipping mail closer to destination and generally involves customers performing work that the Postal Service would otherwise do. To the extent that PostalOne! customers perform worksharing activities, the costs avoided by that worksharing are incorporated in the cost avoidance models presented by witnesses Abdirahman, Miller and Mayes. However, these models do not explicitly distinguish worksharing performed by PostalOne! customers from worksharing performed by other customers.

- A. Please confirm that, to the extent PostalOne! cost savings are reflected in the mail flow models presented by USPS witnesses Abdirahman, all First-Class workshare mailers are given equal credit (on a per piece basis) for those cost savings. If you cannot confirm, please explain.
- B. If First-Class workshare mailers perform work that would ordinarily be performed by Postal employees as a result of the employment of PostalOne!, why do you not consider this a form of worksharing?
- C. If First-Class workshare mailers can dropship their mail closer to the destination saving both dock transfer and transportation costs, why do you not consider this a form of worksharing?
- D. Why is it fair and equitable to give all First-Class workshare mailers partial credit for work performed by only 38 mailers that allows the Postal Service to save significant amounts of money per year?

RESPONSE:

- A. Not confirmed. As noted in the original response, the use of PostalOne! facilitates worksharing, it is not considered worksharing, in and of itself. Witness Abdirahman estimates costs avoided when specified worksharing activities (presorting, making mail automation

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION**

RESPONSE to MMA/USPS-1 (continued):

compatible) are performed. Avoided costs are inherently averages and not mailer-specific estimates; they do not result in adjustments to individual customer's rates based on the customer's use of PostalOne! or any other method of mail preparation. PostalOne! customers preparing presorted First-Class Mail receive the same rate discounts, given a level of worksharing, as non-PostalOne! customers.

B. Rate categories for worksharing have been proposed in prior cases based on the Postal Service's determination that mail prepared in particular ways will reduce the Postal Service's processing and other costs. While some customers may undertake activities that reduce Postal Service costs (for example, to improve service), not all of these activities are incorporated into the current workshare program.

The First-Class Mail rate structure recommended by the Postal Rate Commission in Docket No. R2001-1 did not incorporate a consideration of PostalOne! in the calculation of the First-Class Mail discounts. In this docket, the Postal Service has requested a 5.4 percent across-the-board increase in virtually all rates and fees including presorted First-Class Mail rates. The across-the-board approach maintains the current (Docket No. R2001-1) rate and classification structure, is both fair and equitable, and results in rates

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION**

RESPONSE to MMA/USPS-1 (continued):

that meet all of the pricing criteria of the Postal Reorganization Act. As suggested by the question, one option would have been to propose a direct recognition of PostalOne! use within the First-Class Mail rate structure with the assumed result being that PostalOne! customers may have qualified for lower First-Class Mail rates. If this approach had been used, effectively, PostalOne! customers would have borne less of the escrow burden than customers who did not use PostalOne!.

Because the escrow requirement does not vary with PostalOne! use, or with mail volume, and is not based on the provision of any postal service, it would be unreasonable to propose that any of these bases be used to allocate the escrow-related increase in the revenue requirement. Given the lack of association of the escrow requirement with the provision of postal services, I do not believe that it would be fair and equitable to exempt any subclass or portion of a subclass – either partially or totally – from an equal share in this Congressionally-mandated burden. See responses to VP/USPS-T27-5(d), VP/USPS-T27-6(f)(iii), POIR No. 4, Question 3(c), and POIR 5, Question 4(c).

In a more typical omnibus rate case, the Postal Service may have considered alternate pricing and classification structures, including, possibly, some recognition of factors such as the use of PostalOne! However, it is not clear that this consideration would have

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION**

RESPONSE to MMA/USPS-1 (continued):

resulted in additional discounts for PostalOne! use. It is possible that all the benefits of PostalOne! use are already included in the cost avoidance methodology underlying the First-Class Mail discounts or that the net impact of the use of PostalOne! is so small that no change in the discount would be appropriate.

C. To clarify, as described in the Postal Service's responses to interrogatories MMA/USPS-6 and MMA/USPS-7, any transportation savings associated with PostalOne! are not associated with the dropshipment of First-Class Mail. They typically involve redirection of mail from one local facility to another or assignment of mail to alternate transportation, and not movement of mail by customers closer to its destination. As discussed in previous dockets, the Postal Service has made a policy decision not to propose First-Class Mail dropship discounts.

D. See response to part B.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF MAJOR MAILERS ASSOCIATION
REDIRECTED FROM WITNESS TAUFIQUE**

MMA/USPS-T28-1

Please refer to your proposed rates for First-Class letters, especially as they pertain to the first and second ounces.

- A. Please confirm that the Postal Service has proposed to increase the rate digression between the first ounce and second ounce for First-Class letters. If you cannot confirm, please explain.
- B. Please review the following table of current and proposed rates and digressions between and either confirm that the numbers are correct or make any necessary corrections.

First-Class Rate Category	Current First-Ounce Rate	Current Second-Ounce Rate	Current Rate Digression	Proposed First-Ounce Rate	Proposed Second-Ounce Rate	Proposed Rate Digression
Single Piece	37.0	23.0	62%	39.0	24.0	65%
Presorted	35.2	22.5	64%	37.1	23.7	67%
Mixed AADC	30.9	22.5	73%	32.6	23.7	77%
AADC	30.1	22.5	75%	31.7	23.7	79%
3 Digit	29.2	22.5	77%	30.8	23.7	81%
5 Digit	27.8	22.5	81%	29.3	23.7	85%
Carrier Route	27.5	22.5	82%	29.0	23.7	86%

- C. Please confirm that for standard automation and regular letters, the rate digression between the first and second ounces is 0 %. If you cannot confirm, please explain.
- D. Please explain the rationale for increasing the rate digression between the first and second ounces for single piece and workshare First-Class letters.
- E. Please explain the rationale for why First-Class workshare letters should have a significantly higher rate digression between the first and second ounces than single piece letters have.

RESPONSE:

- A. See response of witness Taufique.
- B. See response of witness Taufique.
- C. See response of witness Taufique.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF MAJOR MAILERS ASSOCIATION
REDIRECTED FROM WITNESS TAUFIQUE**

RESPONSE to MMA/USPS-T28-1 (continued):

D. In this case the witness Potter determined that a 5.4 percent across-the-board rate increase was appropriate to recover the costs of the Congressionally-mandated escrow obligation. As discussed in witness Taufique's testimony (USPS-T-28) and in his responses to parts A through C of this question, application of the 5.4 percent rate change resulted in the proposed rates and the associated "degressions" or differences between the first-ounce rates and the additional ounce rates for single-piece and presorted rates. The intent, in this case, was to increase ALL rates by 5.4 percent (subject to rounding constraints) to equitably distribute the equity burden to all customers on the basis of revenue. The proposed first-ounce and additional ounce rates for single-piece and presorted First-Class Mail are constructed to do this.

Clearly alternate proposals could have either increased or decreased the degression for single-piece or presorted First-Class Mail. For example, the single-piece degression could have been increased if a higher first-ounce single-piece rate had been proposed in conjunction with the proposed 24-cent single-piece, additional ounce rate. Alternatively, the presorted degression could have been reduced if a higher presorted additional ounce rate had been proposed in conjunction with the proposed presorted First-Class Mail first-ounce rates. While, either of these options (or any of several other possible proposals affecting the degression) may

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF MAJOR MAILERS ASSOCIATION
REDIRECTED FROM WITNESS TAUFIQUE**

RESPONSE to MMA/USPS-T28-1 (continued):

have been considered to meet some pre-established ratemaking goal, the ultimate effect of a deviation from the 5.4 percent, across-the-board proposal to establish a desired degression, would be to reallocate the escrow burden within First-Class Mail on the basis of either weight, the amount of worksharing, or both. Because the escrow requirement does not vary with weight or the degree of worksharing, and is not based on the provision of any postal service, it would be unreasonable to propose that any of these bases be used to allocate the escrow-related increase in the revenue requirement. Given the lack of association of the escrow requirement with the provision of postal services, I do not believe that it would be fair and equitable to exempt any subclass or portion of a subclass – either partially or totally – from an equal share in this Congressionally-mandated burden. See responses to VP/USPS-T27-5(d), VP/USPS-T27-6(f)(iii), POIR No. 4, Question 3(c), POIR 5, Question 4(c), and MMA/USPS-1(B).

E. See response of witness Taufique.

**RESPONSE OF USPS WITNESS ROBINSON TO INTERROGATORY
OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T27-1. Please refer to your testimony at page 17, lines 3 and 4, regarding the cost coverage of 102.8 percent for Registered Mail, and Exhibit USPS-27F, at page 6.

- a. Since the Before Rates cost per piece is calculated to be \$11.24 (see OCA interrogatory to witness Waterbury, OCA/USPS-T10-7), based upon the PRC version of costs, please confirm that the Before Rates cost coverage for Registered Mail is 93.9 percent ($\$10.55 / \11.24). If you do not confirm, please explain and provide the correct percent.
- b. Please confirm that a cost coverage of 102.8 percent applied to the After Rates cost per piece of \$11.34 (see OCA interrogatory to witness Waterbury, OCA/USPS-T10-7), based upon the PRC version of costs, would result in an After Rates revenue per piece of \$11.65 ($\$11.34 * 1.028$). If you do not confirm, please explain and provide the correct figure.
- c. Based upon the PRC version of costs, please confirm that an After Rates revenue per piece of \$11.65 represents an After Rates percentage change for Registered Mail of 10.4 percent ($(\$11.65 - \$10.55) / \$10.55$). If you do not confirm, please explain and provide the correct percent.

RESPONSE:

This response incorporates revisions to Registered Mail costs reflected in the responses to OCA/USPS-T10-6 and OCA/USPS-T10-7.

- a. Not confirmed. For the test-year-before-rates, the estimated unit costs using the Postal Rate Commission costing methodology is \$10.54. Response to OCA/USPS-T10-7(b). The test-year-before rates unit revenue is \$10.55.

This results in a cost coverage of 100 percent.

In comparison, for the test-year-before-rates, the estimated unit costs using the Postal Service costing methodology is \$16.71. Response to

**RESPONSE OF USPS WITNESS ROBINSON TO INTERROGATORY
OF THE OFFICE OF THE CONSUMER ADVOCATE**

RESPONSE to OCA/USPS-T27-1 (continued):

OCA/USPS-T10-7(b). The test-year-before rates unit revenue is \$10.55.

This results in a cost coverage of 63 percent.

b. – c

Not confirmed. A cost coverage of 102.8 percent applied to the test-year-after-rates unit cost of \$10.63 (PRC methodology, see response to OCA/USPS-T10-7(b)) would result in an after-rates revenue per piece of \$10.92 ($= \$10.63 * 1.028$). A \$10.92 revenue per piece results in an after-rate percentage change of 3.5 percent ($= (\$10.92 - \$10.55) / \$10.55$).

In comparison, a cost coverage of 102.8 percent applied to the test-year-after-rates unit cost of \$16.77 (USPS methodology, see response to OCA/USPS-T10-7(b)) would result in an after-rates revenue per piece of \$17.24 ($= \$16.77 * 1.028$). A \$17.24 revenue per piece results in an after-rate percentage change of 63 percent ($= (\$17.24 - \$10.55) / \$10.55$).

**RESPONSE OF USPS WITNESS ROBINSON
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE
REDIRECTED FROM WITNESS POTTER**

OCA/USPS-T1-3. Please refer to your testimony at page 7, lines 6-9, concerning Registered Mail service. Assuming the Commission recommends the Registered Mail service fee increases proposed by the Postal Service, please confirm that, based upon current projections, Registered Mail service will not cover its costs, at least until such time as the recommended rates are implemented. If you do not confirm, please explain.

RESPONSE:

Confirmed that, based on the roll-forward of Registered Mail costs (USPS-T-10, WP B), Registered Mail service will not cover its costs in the test-year under the current fees.

Exhibit USPS-27A. However, witness Potter has “directed postal management to organize a cross-functional team to thoroughly review Registered Mail service, including its operations, costs, customer needs and fee structure.” USPS-T-1 at 7. This review may identify changes that would result in Registered Mail covering its costs at some point prior to the implementation of the Docket R2005-1 Registered Mail fees. To the extent possible, the Postal Service would prefer to fully evaluate the situation prior to increasing Registered Mail fees by the 70 percent suggested by the existing cost data. In the event appropriate steps can be taken to address this issue, a deferred implementation strategy will guard against the potential of substantial changes in Registered Mail fees that may later be found to be inappropriate.

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 2, QUESTION 16

16. Please provide the source of mailgrams revenue shown in Exhibits USPS-27A, USPS-27B and USPS-27C.

RESPONSE:

Mailgram revenues shown in Exhibits USPS-27A, USPS-27B, and USPS-27C were calculated as follows:

Calculation of Mailgram Revenue

Base Year FY 2004

	Volume	Revenue	Revenue per Piece
	(a)	(b)	(c) = (b) / (a)
Quarter 1	0.371	0.159	0.429
Quarter 2	0.406	0.173	0.426
Quarter 3	0.491	0.204	0.416
Quarter 4	0.380	0.163	0.430
Total	1.648	0.700	1.702

Interim Year: FY 2005

	Volume	Revenue
	(d)	(e) = (d) * (c)
Quarter 1	0.434	0.186
Quarter 2	0.422	0.180
Quarter 3	0.440	0.183
Quarter 4	0.310	0.133
Total	1.607	0.683

Test Year Before Rates: FY 2006

	Volume	Revenue
	(f)	(g) = (f) * (c)
Quarter 1	0.343	0.147
Quarter 2	0.366	0.156
Quarter 3	0.382	0.159
Quarter 4	0.269	0.116
Total	1.359	0.578

Test Year After Rates: FY 2006

	Volume	Revenue
	(h)	(i) = (h) * (c) * 1.054
Quarter 1	0.343	0.155

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 2, QUESTION 16

Quarter 2	0.366	0.164
Quarter 3	0.382	0.167
Quarter 4	0.269	0.122
Total	1.359	0.609

Sources:

(a) RPW

(d) USPS-T-7 at 348

(f) USPS-T-7 at 350

(h) USPS-T-7 at 354

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

3. The charts below depict the cube-weight relationship for Parcel Select DBMC mail, which is also used as a proxy for DSCF and DDU mail, as developed by the Postal Service for dockets R2001-1 and R2005-1.

- (b) Because the proposed rates are determined by multiplying current rates by 5.4% the underlying cost structure implicitly reflects the cube-weight relationship used in R2001-1. Please discuss the implications of setting rates based on a cube-weight relationship that is clearly different than the actual cube-weight relationship. In particular, discuss the implications on mailers of low-weight parcels, who may be paying a disproportionate share of costs; Postal Service competitors, and overall economic efficiency.
- (c) Please discuss the implications for future rate payers on setting rates that do not reflect the current cube-weight relationship, particularly the possibility of future rate shock for some weight increments of parcel select mail.

RESPONSE:

(b) The proposed 5.4 percent across-the-board rate increase is designed to recover the Congressionally-mandated escrow obligation from customers in a fair and equitable manner based on revenue. As discussed in my testimony, with few exceptions, the Postal Service is proposing an approximately 5.4 percent increase in virtually all rates and fees including Parcel Select rates. As witness Potter explained, the Postal Service, in the absence of the escrow requirement, would not be proposing any changes in rates and fees. Therefore, without the escrow requirement, the current (Docket No. R2001-1) Parcel Select rates would not have changed.

In a traditional rate case, rate design is based on assumptions about the allocation of costs and the relationship of rates to the underlying cost and mail piece characteristics such as the cube-weight relationship in Parcel Select. Over time, changes in these relationships may occur; however, these changes, in and of themselves, do not necessarily result in a Postal Service request to change rates and fees. The decision to request rate and fee changes is based on a comprehensive evaluation of the financial circumstances facing the organization including the revenue

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

requirement, market conditions, operational requirements, and the potential effect of proposed changes on customers and competitors. In this case, the Postal Service determined it would not propose a change in rates and fees if the escrow requirement did not exist

The across-the-board approach to increasing rates and fees in this docket is both fair and equitable, and results in rates that meet all of the pricing criteria of the Postal Reorganization Act. As noted in the question, one option would have been to propose a lower-than-average rate increase for customers who mail low-weight Parcel Select pieces. If this approach had been used, effectively these customers would have borne less of the escrow burden than customers who mail heavier Parcel Select pieces or those who mail using any other class of mail. Because the escrow requirement does not vary depending on cube-weight relationships, with mail volume, and is not based on the provision of any postal service, it would be unreasonable to propose that any of these bases be used to allocate the escrow-related increase in the revenue requirement. Given the lack of association of the escrow requirement with the provision of postal services, I do not believe that it would be fair and equitable to exempt any subclass or portion of a subclass – either partially or totally – from an equal share in this Congressionally-mandated burden. See response to VP/USPS-T27-5(d) and VP/USPS-T27-6(f)(iii).

As discussed in my testimony (USPS-T-27 at 18-19), appropriate pricing for competitive products does not necessarily require that these product always receive the same price increase as less competitive products. However, in this case, which is driven by a Congressionally-mandated escrow requirement, the across-the-board proposal is

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

an indication that the Postal Service has endeavored to propose a rate change that does not unduly harm its competitors.

(c) In proposing any set of rates and fees, the Postal Service considers the effect on customers including the size of the rate change, and any changes in rate relationships. While the observed cube-weight relationship may suggest a direction for Parcel Select rates, this decision should not be made without considering all the circumstances surrounding this relationship. For example, the changes may be driven by transient factors *not likely to persist, may reflect a data abnormality, or may actually be indicative of an underlying change in the cube-weight relationship.* As described in the response to part a, the change in the Parcel Select cube-weight relationship appears only in the FY 2004 data not in the data for the prior years. Therefore, it is possible the observed change does not reflect a change in the Parcel Select mail characteristics but may only be a temporary, and as of yet unexplained anomaly. Without further study, it is premature to factor this change into the Parcel Select rates.

In a traditional omnibus rate case, all of these factors would be carefully considered and rate design proposed that reflected the results of this analysis. In many cases, both the Postal Service and the Postal Rate Commission have taken conservative approaches to changes in operations or costs to permit an ongoing examination of the relationships that drive rate design. See, for example, the Docket No. R2000-1 treatment of Priority Mail network costs; Docket No. R2000-1, PRC Op. at 311. I would expect that the Commission would continue to take a considered approach

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

to changes in rate design if it appears that the change in the Parcel Select cube-weight relationship will persist.

4. Please answer the following questions regarding Priority Mail. In R2001-1, USPS-LR-J-96, page 13 contained weight and the average haul by zone for Commercial Air and Other Air in the base year. Please refer to R2001-1, LR-J-103 Per-Pound Elements worksheet. Weight and the average haul by zone for Commercial Air and Other Air was used to distribute distance-related and nondistance-related air transportation costs to the zones. More specifically, total air pounds is used to distribute nondistance-related air costs to the zones and passenger pound miles is used to distribute distance-related air transportation costs to the zones. R2005-1, USPS-LR-K-37, contains weight and the average haul by zone for FedEx and Other Air.

- (c) Considering that FedEx contract costs are not distance (or zone) related and that the majority of air transportation costs for Priority Mail are FedEx related, please discuss the appropriateness of zoned rates beyond zone 4, for Priority Mail.

RESPONSE:

(c) The Priority Mail rate structure recommended by the Postal Rate Commission in Docket No. R2001-1 incorporated a weight-zone structure with rates increasing as Priority Mail pieces increased in weight and were transported to more distant zones. In this docket, the Postal Service has requested a 5.4 percent across-the-board increase in virtually all rates and fees including Priority Mail rates. The across-the-board approach maintains the current (Docket No. R2001-1) rate and classification structure, is both fair and equitable, and results in rates that meet all of the pricing criteria of the Postal Reorganization Act. As suggested by the question, one option would have been to propose a change in the zoned structure for Priority Mail that would result in a less distance-based rate structure. If this approach had been used, effectively, Priority Mail customers whose pieces traveled to more distant zones would have borne less of the escrow burden than customers whose pieces destined at a less distant zone. Because the escrow requirement does not vary with the distance a piece travels, with mail volume, and is not based on the provision of any postal service, it would be

unreasonable to propose that any of these bases be used to allocate the escrow-related increase in the revenue requirement. Given the lack of association of the escrow requirement with the provision of postal services, I do not believe that it would be fair and equitable to exempt any subclass or portion of a subclass – either partially or totally – from an equal share in this Congressionally-mandated burden. See responses to VP/USPS-T27-5(d), VP/USPS-T27-6(f)(iii), and POIR No. 4, Question 3(c).

In a more typical omnibus rate case, the Postal Service would have considered alternate pricing and classification structures, including possibly full or partial recognition of the Federal Express transportation contract on Priority Mail or other rates. However, it is not clear that a review of the Priority Mail rate structure considering the Federal Express contract provisions would necessarily have resulted in changes in the zoned rate structure of Priority Mail. The decision to revise rate and classification structures is based on a consideration of many factors, only one of which is the underlying characteristics of transportation contracts such as the Federal Express contract structure. In developing rates and classifications, the Postal Service and the Postal Rate Commission must consider all of the pricing and classification criteria. These requirements do not necessarily mandate that the rate structure be changed solely because of changes in the underlying structure of transportation contracts. In fact, the history of Priority Mail transportation contracts suggests that relying solely on the structure of the underlying transportation contract as the basis for rate design may cause unneeded and, perhaps unwanted, changes in the classification structure. Consider, for example, the change in Priority Mail transportation over the last decade from use of scheduled airline transportation to the Emery network to the Federal

Express contract. The underlying cost structure of each of these networks differed; however, neither the Postal Service nor the Commission chose to fully incorporate the effects of each network change in the rate design.

The process of rate design also includes a careful consideration of the effect changes in rates and classifications will have on customers and the establishment of reasonable rate relationships. For example, designing less distance-based Priority Mail rates for items that are transported using the Federal Express contract transportation may have additional effects. For instance, reducing rates for Priority Mail pieces destinating in more distant zones may increase the Postal Service's volume in these zones, thus changing the "distance mix" of parcels flown, which may have an effect on the costs incurred through subsequent transportation contracts. While I do not know the details of the current Fed Ex contract or the contract negotiations, it is not unreasonable to presume that a transportation vendor bids for a contract based on assumptions about the characteristics -- including distance transported -- of the mail to be carried. If this is correct, it is not clear that the costs characteristics of Priority Mail transportation necessarily would remain the same if the mail characteristics were to change in reaction to a change in the approach to Priority Mail rate design. Before making any such changes to the rate design, the potential for these changes and any resultant cost consequences would need to be examined.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-1.

Please refer to your testimony, USPS-T-27, page 13, where you say that "generally speaking, the resulting rates and fees [from a rate case] are not revisited on a periodic basis absent a Postal Service determination that a rate change request is necessary."

Please consider a situation where the Commission believes that a new rate relationship is meritorious and should be recommended, but decides to move in **steps** toward that new relationship in order to impose a series of small effects on mailers instead of one large effect. An example might be that a cost coverage should be changed but will be changed in three moderate **steps** instead of a single large one. Another example could be the introduction of a worksharing discount, or surcharge, or some other rate signal (possibly associated with the redesign of a product), which would lead to an increase in efficiency, where recognition of a cost difference associated with the rate signal would proceed in **steps** from a passthrough of 40 percent, to 60 percent, to 80 percent, to 100 percent.

- a. Please provide any examples of which you are aware where the Postal Service has initiated a separate case just to take a **step** of the kind discussed in this question.
- b. Would you agree that there have been previous occasions where Congress has decided to phase in desired changes in a series of steps, and that it specified that a **step** was to be taken each year, regardless of whether a rate case happened to occur at each of the appropriate times? If you agree, please provide examples of such occasions.
- c. Please explain the extent to which it is your position that taking steps toward desirable new positions should be constrained and spaced by the occasioning of the Postal Service making "determination[s] that a rate change request is necessary," and that, if such determinations should turn out to be made only every five years (due, say, to success in cost control efforts), a four-step adjustment could take as long as 15 years to bring about. If that is not your position, please explain in detail why it is not.
- d. Suppose that the Commission and various mailers share a concern that an inequitable rate situation exists, but that it may not rise to the level of being well-suited for a complaint proceeding. If an omnibus rate case apparently suited to including consideration of the inequitable situation occurs, but the Postal Service decides, for one reason or another, that it should be an across the-board case, please explain the extent to which it is your position that those concerned about the inequitable situation

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

should simply be told to wait for as many years as the Postal Service requires to make a "determination that a rate change is necessary."

- e. Suppose, at the end of one of the five-year periods discussed in preceding part c, the Postal Service decides that an across-the board increase should be proposed. Explain whether it then would be your position that the Commission or any mailer interested in taking the next step toward the more desirable position should simply be told to wait another few years for that step to occur.

RESPONSE:

- a. I am unaware of a specific circumstance when the Postal Service has committed to scheduled rate or classification filings to implement predetermined "steps" through separate cases. However, this is not to say, that the Postal Service does not propose rate or classification filings to move in specific directions. Perhaps the most obvious example of a filing to take "steps" towards a previously established goal was Docket No. MC95-1. More typically, the Postal Service moves gradually to adjust rates, classifications, rate design, and cost coverages over time. These adjustments may be made in the context of omnibus rate filings or minor classification cases depending on the scope and magnitude of the change. For example, over time, the Postal Service has indicated that the First-Class Mail nonmachinable (formerly nonstandard) surcharge should be increased to reflect the additional costs of processing this mail. Consequently, the Postal Service proposed increases in the nonmachinable (nonstandard) surcharge in Docket No. R97-1 and Docket No. R2001-1. Some smaller movements towards specified goals have

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

been undertaken through smaller, minor classification cases. The Periodicals Copalletization experiments are one example of the Postal Service working to reduce Periodicals costs through the establishment of classifications that encourage copalletization of smaller volume Periodicals.

The decision to request an omnibus rate increase depends on the evaluation of a wide range of financial variables and the need to ensure that the Postal Service meets its statutory mandates in a financially responsible manner. See USPS-T- 6. Secondly, an omnibus rate case can serve as a vehicle for proposing changes in rates, classifications, and rate design that will continue to move products and pricing in preferred directions. As discussed in the testimony of witness Potter (USPS-T-1), the Postal Service has filed this rate request solely to recover the Congressionally-mandated escrow obligation and therefore, has not proposed any changes in classifications or changes in relative rates beyond the requested 5.4 percent across-the-board increase.

- b. Yes. The Revenue Forgone Reform Act of 1993 (RFRA) mandated that rates for preferred classes of mail change in steps. As witness O'Hara explained in Docket No. R97-1:

The RFRA provides that the mark-up for each preferred rate subclass is to be determined from the markup for the most closely corresponding commercial subclass. Over a six-year phasing process, the final year of which will be FY 1999, each preferred rate markup is to rise from one-twelfth the corresponding commercial markup to one-half of the commercial mark-up.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

Docket No. R97-1 USPS-T-30 at 10-11. Under the statute, these rate changes were annual and did not require a Postal Service request for rate changes before the Postal Rate Commission.

- c. This is not my position. The Governors' determinations as to whether and when the Postal Service will request any specific rate or classification change are based on their evaluation at a given time of both the financial needs of the Postal Service, and the most appropriate way to meet these needs consistent with the provisions of the Postal Reorganization Act. While I cannot speak for the Governors, management generally weighs the benefits and costs of a variety of options and presents recommendations to the Governors, based on an assessment of the financial circumstances as well as the relative merits of alternative changes in rates and classifications. In this case, Postal Service management determined that, without the escrow obligation, management would not request substantial changes to the current rate and classification schedule.¹ In addition, management determined that, absent the escrow requirement, the financial position of the Postal Service was such that a general rate increase would not be requested. Faced with these two determinations and the possibility that Congressional action could remove the escrow requirement, witness Potter determined that the

¹ Smaller changes to the classification schedule frequently are requested to address specific issues, for example, the establishment of experimental products, market tests, or other classification issues.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

most reasonable approach was to propose an across-the-board increase in rates and fees. USPS-T-1. Generally, the Postal Service has not proposed changes to rates and classifications that would have a substantial effect on Postal Service revenues outside the framework of an omnibus rate case.² This permits an evaluation of the interdependencies of rate and classification proposals and their effect on the revenue requirement.

This question posits a rigid, deterministic approach to rate and classification changes implying that changes could only be undertaken in a stepwise fashion based on a specified formula. The Postal Service does not generally support such an approach to rate or classification changes. Some changes will take longer to accomplish than others, but the ability to flexibly address specific circumstances and mold a solution to these circumstances – as the Postal Service has done in response to the escrow obligation – will, over the long term, benefit both the Postal Service and its customers.

- d. I do not know what situation you are describing. As described in the response to (c) above, the Postal Service evaluates a variety of financial and other concerns prior to proposing an omnibus rate change. The escrow requirement is a unique circumstance that the Postal Service was required to address. In this case, an across-the-board increase in rates

² One exception was Docket No. MC95-1 which proposed substantial changes in classifications.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

and fees is a reasonable approach to recovering the escrow obligation and consistent with the requirements of the Postal Reorganization Act. Under the Act, any change in rates or fees must be initiated through a Postal Service request and the timing of that request is at the Postal Service's discretion.

- e. This is not my position. First, the Commission is the Postal Service's partner in the rate making process; while the Postal Service presents proposals and justifications for its proposals to provide a basis for the Commission's recommended decision, the Commission reaches these decisions independently. Second, the Postal Service develops its request based on an evaluation of the circumstances surrounding the request. In this case, the Postal Service's testimony describes why the across-the-board rate request is reasonable, appropriate and consistent under the pricing provisions of the Postal Reorganization Act.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-2.

Please refer to your testimony, USPS-T-27, page 13, beginning at line 10, where you say that rates may not be revisited on a periodic basis even though:

The reality of changing input prices, productivity and other factors virtually ensures that recommended cost coverages for a test year will not trace precisely the cost coverages that actually result in that year or in any subsequent year prior to a new rate change request. This result is expected and is not inherently unfair or inequitable. [Footnote omitted.]

- a. You mention input prices, productivity, and other factors possibly changing. Do you agree that over a period of several years, such as the interval since Docket No. R2001-1 (which turned out to be settled), the "other factors" that could change extend to (i) major changes in the mechanization and technology used by the Postal Service to process mail, (ii) changes in postal markets, and (iii) substantial changes in the preparation of mail by mailers? Please explain any extent to which you disagree.
- b. Suppose two different products each had a recommended (and expected) cost coverage of 160 percent. Subsequently, when the test year actually occurs, product one has an actual coverage of 130 percent and product two has an actual coverage of 163 percent. Explain whether you would argue in this case that each product traced the recommended coverage, but that neither product traced it "precisely?" Include in your answer a statement on how close the recommended and actual coverages would have to be before you would argue that the tracing had been "precise."
- c. Consider an actual 130 percent cost coverage that is not even moderately close to the recommended coverage of 160 percent, which would certainly qualify as a failure to "trace precisely." You state in your testimony that this is "not inherently unfair or inequitable." If the Commission recommended cost coverages that it believed were fair and equitable and well-aligned with the Postal Reorganization Act of 1970 ("the Act"), and such immoderate variances occurred, please explain why you believe this is "not inherently unfair or inequitable." In your answer, please draw on and explain all notions of fairness and equity that you had in mind when you made this statement.

RESPONSE:

- a. These are other possible factors that could cause recommended cost coverages to differ from actual cost coverages.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- b. I would agree that, in this hypothetical, neither of these products tracked the recommended cost coverage precisely. For the cost coverages to track "precisely," I would expect the recommended cost coverage to be exactly equal to the actual cost coverage.
- c. First, I am unaware of where the Postal Service or the Commission has equated "trace precisely" with "fairness and equity." In addition, I have not used the term "immoderate variances" and do not necessarily agree that a change in cost coverage of the size in your hypothetical is necessarily "unfair or inequitable." However, the Postal Service and the Postal Rate Commission do use previous cost coverages as a point of comparison.

I do not discuss any example of a subclass where the Commission recommended a cost coverage of 160 percent in Docket No. R2001-1 and where the actual cost coverage is 130 percent. Reviewing the Commission's R2001-1 decision, the only subclass with a recommended cost coverage of approximately 160 percent is Priority Mail (recommended cost coverage 159.5 percent). PRC Op. Docket No. R2001-1, Appendix G at 1. In FY 2004, the actual cost coverage for Priority Mail was 156.99 percent, in the test year after rates, the proposed cost coverage for Priority Mail is 156.49 percent (145.94 percent on the PRC costing methodology.)

In your hypothetical, I assume that, in recommending a 160 percent cost coverage, the Commission exercised its best judgment, and considered the record evidence before it at the time to recommend a cost

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

coverage it considered to be fair and equitable. The fact that hindsight permits us to see what the actual cost coverage turned out to be does not make the Commission's recommended cost coverage unfair and inequitable. If undertaken, a *post hoc* review of additional evidence could lead the Commission to conclude that the 130 percent cost coverage is a fair and equitable result.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-3.

Please refer to your testimony, USPS-T-27, page 12, beginning at line 9, where you say that it "would be a breach of the financial management responsibilities established under the Postal Reorganization Act" to "ignore" the "Congressionally-mandated escrow requirement." Immediately following this, you say: "Therefore, we are faced with the necessity of apportioning the escrow expense in a fair and equitable manner."

- a. The logic of your statement appears to be that because it would be irresponsible to ignore the escrow cost, you (or the Commission) are required to apportion it fairly and equitably. Please state any extent to which you disagree that this is the logic of your statement, focusing specifically on the meaning of the word "therefore."
- b. Does the fact that it would be irresponsible to ignore the ordinary institutional costs of the Postal Service imply that you (or the Commission) must apportion them fairly and equitably as well? Please explain any answer that is not an unqualified affirmative.
- c. Can you name any costs of the Postal Service that it would be financially responsible to ignore? If yes, please explain what those costs are.
- d. Can you name any costs that the Postal Service ignores when establishing its revenue requirement? If yes, please explain what those costs are.
- e. Can you name any Postal Service costs that should not be apportioned in a fair and equitable manner? If yes, please explain what those costs are and why they should not be apportioned fairly and equitably.
- f. In proposing what you believe to be the most fair and equitable apportionment of the escrow costs or any other costs, would you exclude consideration of any factors in section 3622(b)? If yes, please explain.
- g. In its Opinion and Recommended Decision in Docket No. MC95-1, page iii, the Commission said: "Congress mandated that '[p]ostal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis.'" (Emphasis in original.) When the Commission apportions the institutional costs of the Postal Service to the subclasses of mail and special services, do you contend that it does so on any basis other than a fair and equitable basis? If yes, please explain.
- h. If the Commission apportions all other institutional costs of the Postal Service on a fair and equitable basis and you see a need to apportion the

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

escrow costs on a fair and equitable basis, not excluding other factors in section 3622(b), please explain whether you see some fundamental difference between the two pools of costs which suggest that what is fair and equitable for one is different from what is fair and equitable for the other. If you do, please explain (i) what those fundamental differences are, and (ii) how those differences interact with notions of fairness and equity to imply different apportionments, being sure to reference your statement on page 4, lines 6-8, where you state that the escrow funds are "treated as an institutional cost of the Postal Service."

- i. In its Opinion and Recommended Decision in Docket No. R90-1, at pages IV-16 and IV-17, ¶¶ 4059 and 4052, respectively, the Commission said: "We utilize total attributable cost in computing a markup index, which is an important tool in developing fair institutional cost distributions, ..." and "We conclude that it continues to be most appropriate to distribute the relative burden of recovery of institutional costs on the basis of coincident application of the policy factors of the Act, with reference to the markup index." You mention on page 23 that you have some reservations about some uses of the Commission's markup index, and you note that following a set of indexes could have significant effects on mailers. Nevertheless, would you agree that the markup indexes for the subclasses of mail are one reflection of the apportionment of institutional costs that the Commission found to be fair and equitable? Please explain any disagreement.
- j. Please confirm that, *ceteris paribus* (meaning mainly in this case that the costs remain the same), applying a uniform proportionate increase to all rates, as in an across-the-board increase, systematically distorts toward the average the markup indexes underlying the original rates. If you cannot confirm, please provide a mathematic proof that this is not the case.
- k. If it is true that an across-the-board proportionate increase systematically distorts the markup indexes of the rates, would it not follow that such an approach is inconsistent with the apportionment of costs that the Commission found fair and equitable? Please explain any extent to which you disagree.

RESPONSE:

- a. My testimony states:

Many industry observers have suggested that a Congressionally-mandated escrow requirement expense that is not caused by the provision of mail services is unfair and inequitable. Nevertheless,

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

the Postal Service cannot simply ignore its existence. To do so would be a breach of the financial management responsibilities established under the Postal Reorganization Act. Therefore, we are faced with the necessity of apportioning the escrow expense in a fair and equitable manner.

USPS-T-27 at 12 lines 9-15.

The Postal Service does not ignore any costs when it develops rates to meet its revenue requirement for a requested change in rates and fees. In this instance, these costs include the Congressionally-mandated escrow expense. While your paraphrase of my testimony generally captures the logic, my testimony is based on the Governors' determination that a request to change rates and fees is necessary to meet the Postal Service's revenue requirement. This need is discussed fully in the testimony of witness Tayman (USPS-T-6).

I use the word "therefore" as it is commonly used in everyday language. It is defined as:

1a: for that reason: CONSEQUENTLY b: because of that c: on that ground 2: to that end

Merriam-Webster's Collegiate Dictionary, 10th edition. (Springfield MA: Merriam-Webster, Incorporated, 2002) [emphasis in the original].

- b. Yes, in proposing or recommending rates and fees it would be irresponsible to ignore any institutional costs of the Postal Service whether they are associated with the escrow requirement or the provision of postal services.
- c. No.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- d. No.
- e. No.
- f. No.
- g. No.
- h. I am not sure of what question you are asking. A fundamental difference between the escrow obligation and other institutional costs is that the escrow obligation is a legislative construct and the other institutional costs usually reviewed by the Commission are actually incurred as a result of the operation and administration of the Postal Service. However, if you are asking "can the Postal Service and the Postal Rate Commission arrive at different results in some instances," the answer is yes. By the same token, as depicted in its Docket No. R2001-1 decision, the Commission arrives at different results in different cases based on the particular circumstances in the case. Docket No. R2001-1, PRC Op. Appendix G at 37. I do not believe that means that, in one instance, the Postal Rate Commission apportioned the costs fairly and equitably, and in another instance it failed in that regard.
- i. I would agree that the markup indices are one indication of the relationships embodied in a Commission recommended decision on a Postal Service rate request. However, that recommendation depends on the Commission's determination of the appropriate markup relationships in a specific docket based on its application of the pricing criteria in that

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

docket. I am concerned not with the calculation of the indices for any specific rate decision but with efforts to mechanically apply past relationships to new circumstances.

- j. Confirmed that if costs remain the same both before and after the rate change, that applying a uniform percentage increase to all rates will move the markup indices for individual subclasses closer to the system average markup index.
- k. First the question presupposes that some specific set of markup indices are the only possible "fair and equitable" markup indices. I do not believe this to be the case and believe that all circumstances surrounding a rate request must be considered before a given set of rates, cost coverages and markup indices can be determined to be fair and equitable. Efforts to force fit past coverages to a new case can only succeed if one is compelled to ignore all new information and solely dwell on the past

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-4.

Please refer to your testimony, USPS-T-27, beginning on line 24 of page 5, where you state that "the escrow requirement is a unique financial circumstance that merits a different approach than has been used in prior omnibus rate cases." (Emphasis in original.)

As a hypothetical, please assume the following outcome occurs. First, suppose an across-the-board increase is implemented as proposed. Second, assume that in FY 2006, after making the required escrow deposit, the Postal Service achieves financial breakeven. Third, to avoid yet another rate increase in FY 2007, assume Congress allows that normal operations in FY 2007 can draw on both the FY 2006 escrow account and the amount that would have been put in escrow in FY 2007, and this in fact allows breakeven in FY 2007.

- a. Would you agree that the rate relationships in FY 2007, which the Act gives the Commission the authority to recommend, should be guided by the factors in section 3622(b) of the Postal Reorganization Act (including any other relevant policies of the Act)? Please explain any disagreement.
- b. Would you agree that the rate relationships existing at the end of FY 2006 would be the result of a prior across-the-board approach, which you characterize as a "different approach," adopted because of what you refer to as "a unique financial circumstance." Please explain any disagreement.
- c. Would you agree that carrying the across-the-board rates into FY 2007 would result in rates for that year that were guided by an earlier application of an across-the-board approach instead of by an unencumbered application by the Commission of the 3622(b) factors? Please explain any disagreement.
- d. Under the hypothetical conditions assumed for this question, would you propose that the across-the-board rates be completely withdrawn at the end of FY 2006 and that a new set of rates be implemented, with the same breakeven revenue requirement, and that the new set of rates for FY 2007 be set according to what you call the approach "used in prior omnibus rate cases?" (USPS-T-27, p. 6, l.1.)
- e. If you would not propose the steps outlined in part d of this question, but would instead argue that the approach used to fund the escrow payments in FY 2006 is also the approach that should be used to fund the more-traditional operating requirements of FY 2007, please explain how the escrow approach accommodates what you see as the "unique" difference between the burden associated with the escrow and the burden associated with FY 2007 operations. In other words, how can the escrow

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

approach be something "in contrast to the approach to rate and fee levels usually taken by the Postal Service and the Postal Rate Commission," justified by unique circumstances, and yet be suitable for the normal operations that warrant "the approach . . . usually taken?" (USPST-27, p. 3, ll. 9-11.)

- f. Under the assumptions of this question, please explain how it would be fair to mailers and consistent with the Postal Reorganization Act for the rates in FY 2006 to be based on a "different approach" and for the same rates in FY 2007 to be suitable for covering the ordinary operating requirements of FY 2007.
- g. Under the assumptions of this question, if you believe it would be fair to carry the FY 2006 rates into FY 2007, please explain why this does not suggest that there is really no difference between the financial burden of FY 2006 and the financial burden of FY 2007.
- h. Do you agree that — if the across-the-board proposal is recommended and implemented in this case, and if the rates of that proposal are not rescinded when the "unique" circumstances of the escrow burden no longer apply, but are instead used as a platform relative to which any future rate increases will be proposed — it follows that any consideration given in future cases to the effects of rate increases on mailers will be referenced to a set of rates selected under unique circumstances, and thus would not be referenced to rates set in a normal omnibus case? Please explain any disagreement.

RESPONSE:

This question poses a hypothetical series of events that I have not studied and assumes Congressional actions that may or may not occur. The Postal Service's proposals in this docket are based on the circumstances and the statutory requirements that currently exist. Witness Potter (USPS-T-1) has stated that the Postal Service will withdraw this request if legislation is enacted that removes the escrow requirement while the request is pending.

- a. I agree that, if the Postal Service requests a change in rates and fees at some time following the conclusion of this docket (the assumption of your

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

hypothetical that the "across-the-board increase is implemented as proposed") and the current statute is still in effect, then the Commission's recommended decision in that later docket would be guided by the factors in section 3622(b) of the Act and these recommendations would also be based on any other relevant policies of the Act. I have no testimony to offer in this proceeding regarding future rate cases.

- b. If the Commission were to recommend and the Board of Governors were to accept and implement the rates proposed by the Postal Service in this docket prior to October 2006, then I would agree that the rate relationships existing at the end of FY 2006 would be based on the across-the-board rate proposal discussed in my testimony and that of witness Taufique (USPS-T-28). As I discuss in my testimony, this approach to rate design differs from the approach that typically underlies Postal Service rate proposals.
- c. See my response to part b. I would also agree that the reason underlying the across-the-board rate change was because of the existence of the escrow requirement. This requirement is a unique financial circumstance.

I would not agree that the Commission's application of the 3622(b) factors and its recommendation in any docket -- including the present docket -- has been or will be "encumbered" by the Postal Service's proposals in that docket.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- d. The Governors of the Postal Service make all decisions as to whether the Postal Service will request a change in rates or fees. If my opinion is solicited by the Governors, at the end of FY 2006, I will assess the facts in front of me at that time and offer my advice. However that is a matter beyond the scope of my testimony.
- e. See response to d.
- f. My testimony concerns a request for rates and fees to be implemented in FY 2006. Speculation about events beyond that period are beyond the scope of my testimony.
- g. See response to part f.
- h. See response to part f.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-5.

In regard to the cost coverage of ECR mail, please refer to the following statements by Postal Service witnesses. In Docket No. MC95-1, under the heading of "Efficient Mail Pays Disproportionate Contribution," witness McBride said:

Exactly the same situation occurs in bulk regular third class, where the efficient carrier route category has a cost coverage 94 percentage points higher than the other category. [Docket No. MC95-1, USPS-T-1 at 16-17.]

And in that same docket, witness Moeller said:

The creation of the subclasses [in third-class mail] will enable the assignment of markups in a manner which may lead to more equitable rates, [and] if we were starting from a situation where the coverages for the three [third-class] subclasses were equal, **a somewhat lower coverage for Enhanced Carrier Route** relative to the combined coverage for the three new subclasses **could be supported**. [Tr. 11/4135, 4275, respectively, emphasis added.]

In support of a proposed coverage of 228 percent for ECR mail in Docket No. R97-1, witness O'Hara said:

This [percentage rate increase for ECR] is somewhat below the system-wide average increase, **reflecting a desire to lower the very high cost coverage of this subclass**. [USPS-T-30 at 34, emphasis added.]

In support of a proposed coverage of 208.8 percent for ECR mail in Docket No. R2000-1, percent, witness Mayes testified:

This [percentage rate increase for ECR] is somewhat below the system-wide average increase, **reflecting a desire to lower the very high cost coverage of this subclass**. [USPS-T-32 at 38, emphasis added.]

And in Docket No. R2001-1, in support of proposed coverages for ECR/NECR mail, witness Moeller said:

The Postal Service is proposing a cost coverage of 217.8 percent over volume variable costs for the ECR/NECR subclass, which results in a 6.2 percent average rate increase for ECR, and a 6.5 percent increase for NECR. These are somewhat below the system average increase, **reflecting a desire to lower the very high cost coverage of this subclass**. [USPS-T-28 at 36, emphasis added.]

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- a. Please explain the extent to which it has been the Postal Service's intention and expectation that over time the "very high cost coverage" on ECR would and should be reduced from its estimated level of 218.1 percent at the time of Docket No. MC95-1. (Op. & Rec. Dec., App. F.)
- b. Would you agree that if the cost coverage of ECR is not reduced over some period of time following its creation, then the creation of ECR as a separate subclass will have failed to achieve "more equitable rates" and to reflect "market characteristics"? (See response of Postal Service witness Moeller, Docket No. MC95-1, Tr. 11/4135 and 4146, respectively.) If you agree, please explain whether a period that is now approaching 10 years should be long enough to see some results. If you do not agree, please state and explain all reasons for your position.
- c. Please explain whether any reduction in the "very high cost coverage" of ECR should be limited to reductions occurring in omnibus rate cases, of which there have been only three since reclassification, one of which was settled due to special circumstances. If you do not believe such reductions in cost coverage should be so limited, please explain what other ways of reducing the coverage should be considered.
- d. Please confirm that, by virtue of the across-the-board proposal in the instant docket, it is the Postal Service's position that yet another opportunity to reduce the "very high cost coverage" of ECR should be lost and that the existing situation should be perpetuated. Please explain fully any failure to confirm.
- e. If a relevant next case (meaning a case candidate for reducing the "very high cost coverage" of ECR) after the instant docket is characterized by important product redesign proposals, please explain whether it would be the Postal Service's position that that next case should not be used as well to adjust relative cost coverages, on the grounds of limiting the effects on mailers.

RESPONSE:

To clarify, the cites to witness Moeller's testimony in Docket No. MC95-1 are:

ANM/USPS-T-18-3

- c. In light of your responses to parts a and b, please explain how creation of the three subclasses will greatly improve equity.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE:

- c. The creation of the subclasses will enable the assignment of markups in a manner which may lead to more equitable rates.

Docket No. MC95-1, Tr. 2/4135; and,

OCA/USPS-T18-18. [As follow up to prior interrogatories]. . . . Those interrogatories asked you to indicate what cost coverage you *would recommend* for the three subclasses of Standard Mail assuming a systemwide cost coverage of 156.8 percent. The purpose of the interrogatories was to ascertain the relative magnitude of the difference in cost coverage for the three subclasses assuming the constraint of avoiding major rate relationship changes did not exist.

. . . you may also assume that the Standard Mail cost coverage is 150.9 percent, the same as the third-class bulk regular rate coverage in Docket No. R94-1. . . .

- a. How much below the combined coverage for the three new subclasses would you expect the Enhanced Carrier Route cost coverage to be? Would the cost coverage be approximately 10 percent, 20 percent, 30 percent, etc. below the combined cost coverage for the three new subclasses?

RESPONSE:

- a. . . . [I]f we were starting from a situation where the coverages for the three subclasses were equal, a somewhat lower coverage for Enhanced Carrier Route *relative to the combined coverage* for the three new subclasses could be supported. Even with the waiver of the constraint of avoiding major rate relationship changes, I have *insufficient information* to speculate as to how much lower of a coverage could be supported, but in the situation you describe it could be as little as 10 percent.

Docket No. MC95-1, Tr. 2/4275-6.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- a. The Postal Service did not characterize the Commission's Docket No.

MC95-1, recommended cost coverage of 218.1 percent as "very high." In that docket, witness Moeller discussed the pricing criteria with respect to the proposed Enhanced Carrier Route subclass. In his testimony witness Moeller concluded that: "The criteria which point to a relatively low cost coverage are outweighed by the desire to avoid major rate relationship changes." Docket No. MC95-1, USPS-T-18 at 8. In the Postal Service's request, the proposed Enhanced Carrier Route subclass cost coverage was 212 percent.

Postal Service proposals (and Commission recommended decisions), propose rate levels and cost coverages based on the application of the pricing criteria of the Postal Reorganization Act. This process involves a balancing of many conflicting considerations to arrive at a proposed cost coverage. Simply because a cost coverage is "high" in relative terms, does not necessarily mean that it is inappropriate, given all of the factors that must be considered. In fact, in each case that you cite, the Postal Service witness reached the conclusion that, while the ECR cost coverage could be characterized as "very high" relative to the cost coverages of other subclasses, that cost coverage was appropriate and consistent with the requirements of the Postal Reorganization Act. In these dockets, the Commission has reached similar conclusions recommending cost coverages that were not substantially dissimilar to the

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

Postal Services proposals, once costing methodology differences are considered.

- b. No. The Enhanced Carrier Route subclass provides options for customers mailing geographically targeted advertising that are not available in the Standard Regular subclass. By creating a separate ECR subclass, market and demand differences were recognized not only in the rate structure, but also to a greater extent in the classification structure. While subclass level cost coverages are not fully independent due to the break-even constraint, subclass status provides opportunities for re-evaluating coverages and rates with fewer constraints than may otherwise exist if ECR has not been created as a separate subclass.
- c. For any fiscal year, the cost coverage for ECR can be computed, and this cost coverage will change depending on the mail mix and operational results for that year. One obvious, but not desirable, way to reduce the cost coverage for ECR is for the Postal Service to become less efficient in handling this mail. Another way to reduce calculated cost coverages would be to change the underlying costing methodology. However, neither of these changes in cost coverage would affect the actual rates that customers pay – and could occur even if, as has been the case since 2002, ECR rates declined in real terms (did not change in nominal terms).

Within the context of an omnibus case, the evaluation of cost coverage for ECR should and is based on the application of the pricing

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- criteria. In this case, and in prior dockets, while noting relatively high cost coverages for ECR and for other categories of mail, the Postal Service has determined that these cost coverages and the associated rates can and are supported by a reasoned application of the pricing criteria.
- d. Not confirmed. The Postal Service has proposed the across-the-board increase as the most appropriate way to incorporate the Congressionally-mandated escrow requirement into rates in a circumstance where the Postal Service would not otherwise have filed a rate request and rates would not otherwise be changed. In addition, if, as your questions seem to suggest, the rate proposal favored ECR and a smaller rate increase was proposed, then that revenue must be recovered from some other class of mail. ECR contribution will increase by approximately \$205 million dollars between the test-year-before rates and the test-year-after-rates. As compared to the rates that are proposed by the Postal Service, eliminating the incremental contribution from ECR would roughly equate to an additional increase of approximately one-cent in the First-Class Mail additional ounce rates; an additional 9 percent increase in Periodicals revenue; over a 3.7 percent increase in Standard Mail Regular after-rates contribution; or, a need to find additional contribution equal to 80 of the Parcel Post after-rates contribution.
- e. To my knowledge, this possibility has not been considered.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-6.

Please consider the proposed cost coverage for ECR Standard Mail.

- a. Please identify, by page and line references, the specific places in your testimony where you discuss the proposed cost coverage for ECR mail.
- b. Please clarify whether your assessment of the proposed ECR cost coverage focused on the suitability of its absolute level (in view of the section 3622(b) factors) or on the proximity to the cost coverage recommended in Docket No. R2001-1, the latter of which seems to be suggested by your discussion of markup indexes beginning on line 7 of page 23 of your testimony, USPS-T-27.
- c. USPS-LR-K-114 shows the proposed markup index for ECR to be 1.622 (under Commission costing) and the corresponding markup index of Docket No. R2001-1 to be 1.560.
 - (i) Please explain whether the increase from 1.560 to 1.622 is one of the comparisons you had in mind when you said on line 1 of page 24 of your testimony that "most of the relative relationships resulting from the prior docket are maintained."
 - (ii) Please state whether it would be your proposal that the index level of 1.622 should become part of the "cumulative evaluation of the ratemaking criteria and the relative weightings of each" to which you refer beginning on line 11 of page 23 of your testimony.
 - (a) If you believe it should become part of the "cumulative evaluation," please explain how it is fair to ECR mailers for all of their future rates to receive a step increase based on what you refer to in other places as a unique circumstance in this case.
 - (b) If you do not believe it should become part of the "cumulative evaluation," please explain how its effect should be removed.
- d. Please refer to Exhibit USPS-27D in your testimony, showing a rate increase for ECR mail of 5.5 percent and for ECR Nonprofit mail of 6.0 percent, and to witness Taufique's testimony, USPS-T-28, page 11, lines 17-18, proposing rate increases for the same categories of 5.6 percent and 5.9 percent. Please explain which of these figures is correct, or present the correct figures.
- e. In evaluating the effects of the proposed cost coverage of ECR on mailers, please explain the consideration you gave to the apparent fact that, under

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

your proposal, Nonprofit ECR mailers are to receive a larger increase than commercial ECR mailers.

- f. Suppose Public Law 106-384 were interpreted to require that Nonprofit ECR mailers must receive a rate increase of 13 percent, as referred to by witness Taufique (USPS-T-28) on pages 11–12 of his testimony.
 - (i) Please explain whether you would regard an increase of 13 percent for the preferred category of Nonprofit ECR to be fair and equitable and to be acceptable under the unique circumstances of this case.
 - (ii) If you would not regard the 13-percent increase to be acceptable, please explain what steps you would recommend to reduce that effect.
 - (iii) If reducing the effect on Nonprofit ECR mailers were seen to be a desirable goal, please explain why reducing the cost coverage on ECR mail would not be an acceptable way to accomplish that goal, especially in view of the fact that the cost coverage of ECR is extremely high and that the proposal is to increase its markup index, as discussed in part c of this question.

RESPONSE:

- a. My testimony discusses why I believe that the across-the-board approach used in this case results in rate levels that are consistent with the pricing criteria of the Postal Reorganization Act. While I do not discuss the application of the pricing criteria to Enhanced Carrier Route Standard Mail explicitly, I believe that the resulting cost coverage for ECR (as well as the coverages for all other subclasses and special services) are consistent with the requirements of the Postal Reorganization Act.
- b. My assessment of the proposed ECR cost coverage (as well as the cost coverages of the other subclasses and special services) focused on the absolute level of the cost coverage, the change in cost coverage from those recommended in Docket No. R2001-1, as well as the other statutory

• RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

considerations of the Postal Reorganization Act. The use of markup indices provides one indication of changes in relative cost coverages but does not, in and of itself, necessarily indicate that a cost coverage for a specific subclass is too high or too low. The relative markup index for a subclass could, for example, change when the underlying cost coverage for that class does not change due to shifts in the application of the pricing criteria to other subclasses of mail.

c.

- (i) Yes. Generally, those subclasses of mail which had high markup indices in Docket No. R2001-1 have high markup indexes under the Postal Service's current proposal.
- (ii) The cumulative evaluation of the rate-making criteria and the relative weightings of these criteria have resulted in the rate structure that exists today. If the Postal Service's proposal in this docket were recommended by the Commission and approved by the Governors and implemented by the Board of Governors, the across-the-board treatment of the escrow requirement would be incorporated in the resulting rates.
 - (a) While the rates at any time reflect the cumulative evaluation to that point of the rate making criteria and the relative weightings of the criteria in prior Commission recommended decisions, the Commission may choose to

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

change these weightings if it considers this to be appropriate. As I have previously indicated, the Commission's markup index suggests that it does reassess and respond to new circumstances as appropriate. Given the circumstances underlying this case, the Postal Service has determined that it would not otherwise change rates and fees and is doing so solely to recover the escrow requirement. My testimony provides the rationale and recommendations that the Postal Service believes are appropriate for addressing these new circumstances..

(b) See (a)

- d. The two sets of numbers reflect different methods of calculating a change in rates. I have calculated percent changes keeping volume and mail mix constant, this more accurately shows the actual changes in rates that would be paid as a result of the Postal Service's proposal. Witness Taufique informs me that the percent changes calculated in his testimony reflect changes between the test-year-before-rates and the test-year-after-rates allowing the volume and mail mix to change.
- e. In preparing my testimony I was aware that the proposed rate increase for Nonprofit ECR customers is higher than the proposed rate increase for commercial ECR customers. It is my understanding that the proposed

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

rates for both ECR and NECR were developed by applying the same 5.4% increase to each rate element. The difference in the final percentage rate increase between ECR and NECR can be explained by the need to apply the customary one-tenth of a cent rounding constraints and the need to make several minor adjustments to the preliminary rates to preserve the uniform sizes of workshare discounts and the residual shape surcharge across presort levels and Standard Mail subclasses.

- f. The provisions of section 3626 establish requirements affecting the relationship between the rates for the nonprofit and commercial Enhanced Carrier Route subclasses. These provisions were established to ensure preferential rate treatment for nonprofit subclasses as compared to their commercial counterparts. These requirements are imposed on the results of the rate design for nonprofit subclasses and their commercial counterparts.
 - (i) If the statute required a 13 percent increase in NECR rates, the Postal Service would have proposed rates that met this requirement. Meeting this assumed requirement would be similar to the case of Registered Mail where the statutory requirements led to a 70 percent proposed fee increase. In this case, the Postal Service determined that the proposed 6 percent increase was fair and equitable and was consistent with the requirement that the NECR average revenue per piece be nearly as practicable equal to

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

60 percent of the average revenue per piece for ECR. See USPS-T-28 at 11-12.

- (ii) See response to part (i). In evaluating the cost coverages and the rates resulting from the application of the across-the-board increase, it was determined that the current proposal met the requirements of the Act.
- (iii) It may be possible that some alternative rate design could reduce the overall cost coverage of the combined ECR and NECR subclasses, reduce ECR rates as compared to the current proposal, and result in the average revenue for NECR being exactly equal to 60 percent of the average revenue per piece for ECR. However, granting ECR preferential treatment – a lower rate increase – would effectively penalize non ECR subclasses through a higher percentage rate increase. Given the lack of association of the escrow requirement with the provision of postal services, I do not believe that it would be fair and equitable to exempt any subclass – either partially or totally – from an equal share in this Congressionally-mandated burden.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-7.

Please refer to the following statements from the Opinion and Recommended Decision in Docket No. MC95-1.

Quantitative and qualitative evidence in the record does support a finding that there are **market differences** between carrier route and noncarrier route Standard Mail. The Commission recommends the creation of an Enhanced Carrier Route subclass to reflect this. [p. I-7, ¶ 1017, emphasis added.]

The Commission adheres to the view that the classes should only be subdivided when a valid reason to do so exists, such as to allow better application of the statutory ratemaking criteria. [p. III-8, ¶ 3019.]

Large differences in own-price elasticities are clearly important evidence supporting separate treatment under § 3622(b)(2). [p. III-45, ¶ 3120, emphasis added.]

The Commission is satisfied that the proposed Enhanced Carrier Route subclass has **distinct demand characteristics** which indicate differences in value to senders. [p. III-46, ¶ 3121, emphasis added.]

The Commission concludes, based on this record, that the only benefit of disaggregating subclasses further would be the ability **to reflect differences in demand** or other non-cost factors of the Act in separate markups." [p. IV-115, ¶ 4253, emphasis added.]

Fourth, the **own-price elasticities and other demand characteristics** of carrier route and noncarrier route mailers are sufficiently different so that separate rates and discounts for carrier route and noncarrier route mail should improve the equity and economic efficiency of the postal rate structure. [p. V-189, ¶5460, emphasis added.]

Please refer also to the following statement from the Opinion and Recommended Decision in Docket No. R77-1:

If presorted first-class constitutes a 'class of mail' or 'type of service' for purposes of [§ 3622(b)], it follows that the rate adopted must be based on an **independent application of the § 3622(b) factors**. [Op. & Rec. Dec., Docket No. R77-1 at 241, fn. 1,7, emphasis added.]

In addition, please note that the own-price elasticity of quantity demanded of ECR is estimated by witness Thress to be -1.093 (42 percent more elastic than

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

the corresponding estimate of -0.770 in Docket No. R2001-1, see USPS-T-8, p. 50). In the instant docket, see USPS-T-7, Table 1, p. 9.

- a. Please state whether, in your opinion, the current rate relationships, which the across-the-board proposal would perpetuate, adequately and acceptably recognize the "market differences" between ECR and Standard Regular mail, the "[l]arge differences in own-price elasticities" between these two subclasses, and the "distinct demand characteristics" of ECR mail, all emphasized by the Commission as items of importance in its decision to recommend the ECR subclass.
- b. If the answer to preceding part a is affirmative or in part affirmative, please explain in detail how (i) the market differences, elasticity differences, and demand differences between ECR and Standard Regular mail are recognized in the existing rates and unit contributions to institutional costs, and (ii) how these factors are recognized in the proposal in this docket for an across-the-board rate increase.
- c. Unless your answer to part a is an unqualified affirmation, please explain the time frame and the steps which should be taken to recognize adequately the market differences, elasticity differences, and demand differences between ECR and Standard Regular mail.
- d. If the answer to part a is less than an unqualified affirmation and the answer to part c is explicitly or implicitly that no steps should be taken in this case, please explain whether it is in effect the Postal Service's position that the unique circumstances of this case justify the perpetuation of relationships that do not properly recognize the market differences, elasticity differences, and demand differences between ECR and Standard Regular mail.
- e. If the Postal Service believes that some benefits from disaggregating have been realized since Docket No. MC95-1, please list separately (i) each benefit realized, and (ii) which subclass of mail has realized each benefit.

RESPONSE

a-e The across-the-board rate proposal maintains the rate relationships embodied in the current rates and these rate relationships recognize the underlying cost and demand differences between ECR and Standard Regular Mail. The Enhanced Carrier Route rates and rate design reflect

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

market differences, elasticity differences and demand differences between ECR and Standard Regular by having rate structures which reflect the differences in the purposes for which these two subclasses are used. Advertising mailed using ECR rates is typically targeted customers who are more highly concentrated within specific geographic markets. Conversely, Standard Regular is typically used for advertising messages which are not as geographically targeted. This is reflected in the rate structure for ECR which offers rate options for high density and saturation advertising that are lower than those offered for Standard Mail Regular.

While the Postal Service has indicated in the past a desire to reduce the relative cost coverage for Enhanced Carrier Route over time, it does not intend to do this without fully considering the circumstances which surround each rate request. The process of adjusting ECR's relative cost coverage has been and will continue to be a gradual approach that will be influenced not only by measured costs, and cost coverages, but also rates, rate relationships and rate changes. This approach is consistent with the Postal Service's approach to rate design and rate levels for all classes of mail, not just ECR.

In this case, the Postal Service determined that projected revenues would be sufficient to meet its revenue requirement absent the escrow obligation. Consequently, the Postal Service would not have instituted a rate request if it were not for the escrow requirement. ECR rates would

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

not have changed relative to either Standard Regular rates or the rates of any other subclass. Facing this situation, I believe it would be inequitable to increase, say, Standard Regular or First-Class Mail rates disproportionately solely because the escrow requirement has been imposed. Effectively, the non-ECR subclasses would bear more of the burden of the escrow requirement.

The existing rate structure embodies the balancing of the nine pricing criteria since reorganization. This balancing has included the creation of the ECR subclass following Docket No. MC95-1 and the establishment of rates to address the needs of a specific segment of Standard Mail. While some additional adjustments may become necessary, this is not the time to undertake adjustments to rate relationships or rate designs. The potential for Congressional action removing the escrow requirement must be considered. The proposed across-the-board rate increase permits the Commission to separate the escrow obligation from other issues in rate design that would not otherwise be raised by the Postal Service.

VP/USPS-T27-8.

On page 4 of your testimony, USPS-T-27, you refer to section 3622(b) of the Postal Reorganization Act, which requires attention to, among other things, section 3622(b)(3), which is:

the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributed to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type....

On page 16 of your testimony you discuss this requirement as "specifying that each class of mail must at least bear the direct and indirect postal costs attributed to that class." In the rest of the associated subsection of your testimony, you discuss incremental costs and the costs for Registered Mail. See subsection "C. Cost," beginning on page 16 and ending on page 17.

- a. Please confirm that you believe a statement that each subclass must at least bear its attributable costs is essentially the same as, and captures virtually the full meaning of, a statement (in the law) that each subclass must bear the "direct and indirect postal costs attributed to that [sub]class or type plus that portion of all other costs of the Postal Service reasonably assignable to such [sub]class or type." If you do not confirm, please explain what you see as the differences between the two statements.
- b. Please discuss whether it is basically your position that the requirement of section 3622(b)(3) can be met by setting rates in neglect of attributable costs and then checking ex post to see if those rates "at least" cover their associated attributable costs. If this is not your position, please clarify in step-by-step fashion how you believe the cost recognition of this section should be carried out.
- c. Please consider the simple restatement that section 3622(b)(3) requires that the rates for a subclass recognize the costs of the subclass and then be based on those costs.
 - (i) Is it your position that there is essentially no difference between this restatement and your statement that the rates for a subclass must "at least" cover the costs of the subclass? Please explain any answer that is not an unqualified affirmative, and how you see the two statements to be substantially different.
 - (ii) The term "cost-based" rates can be used to refer to rates which are based upon the costs of the mail in question being known and acknowledged, with a markup over such costs (in line with a

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

rational, defensible decision as to what the markup should be) to arrive at the rates. Do you agree with this definition? If you do not, please explain any disagreement and provide your own definition of "cost-based" rates.

- (iii) In general, is it your position that when the Postal Service recognizes current costs in appropriate ways it can meet mailer needs more efficiently and effectively? Please explain any disagreement. Also, please explain any terms in your answer that you believe will not be appropriately understood.
- d. Please suppose the following: (1) rates are set in the instant case in an across the- board approach in neglect of current costs, with an after-the-fact check to see if the costs are covered in a degree that seems within bounds (as you appear to do in your discussion surrounding "Table 3" on pages 22 through 24 of your testimony); (2) the rates in the rate case immediately following this case are set by looking directly at then-current costs and deciding on an appropriate markup (as the Commission normally does); (3) the next rate case also makes some product redesign changes (along the lines that currently are known to be under consideration); and (4) cost estimates change from Docket No. R2001-1 to this docket to the next docket (as the Postal Service's costs normally do, especially when there are changes in technology and other improvements in the system).
- (i) Under these conditions, do you think it likely that mailers would see no changes in relative rates in this case and large changes in relative rates in the next case, due to the need to catch up from making no changes in this case? If you do not think this is likely, please explain all reasons why it is unlikely.
 - (ii) Please confirm that in recent years there has been discussion in postal circles and various newsletters about a desire by mailers for smaller, more frequent rate changes instead of larger and less frequent rate changes. If you do not confirm, please discuss the pros and cons of those two approaches to ratesetting.
 - (iii) If greater recognition of costs occurred in this case, along lines that you refer to as "traditional" on line 16 of page 20 of your testimony, do you believe that any rate adjustments viewed as needed in the next case could be smaller? Please explain any answer not in the affirmative.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

- (iv) If large rate adjustments were found to be needed in the next case, but were tempered in recognition of the effects on mailers, do you agree that this would further prolong the time needed to reach desired rate positions, prolonging it until such time as the Postal Service makes a "determination that a rate request is necessary?" (USPS-T-27, p. 13, ll. 9-10.) Please discuss any disagreement.
- (v) Please provide your assessment of the possibility that in the rate case immediately following the instant case the Postal Service will be juggling the need for large rate adjustments to recognize then-current costs and the need for adjustments to implement product redesign changes, and that concern over the former will slow progress on the latter, leading to a less efficient Postal Service than would be possible if adjustments were made in this case to recognize current costs more fully.

RESPONSE:

- a. Criterion 3 imposes an attributable cost floor in "the requirement that each class or type of mail service bear the direct and indirect postal costs attributable to that class or type." Criterion 3 also imposes a requirement that the total revenue from the Commission's recommended rates and fees be sufficient to recover "all other costs of the Postal Service." This second requirement is met through the assignment of institutional costs among the various subclasses and special services. PRC Op. Docket No. R2000-1 at 194-5. Confirmed that the inclusion of the phrase "at least" is intended to reflect the second part of the section 3622(b)(3) criterion addressing the assignment of institutional costs to the various subclasses.
- b. No, this is not my position. For each subclass and special service, the rates recommended by the Commission must cover attributable costs.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

This is a requirement placed on the outcome of the Commission's deliberations. Section 3622 does not impose an "ordering" on consideration of the nine pricing criteria requiring that criterion 3 be considered first, last, or in any other position relative to the consideration of the other eight criteria.

The assignment of institutional costs to the subclasses of mail and special services is accomplished through the application of the eight (non-cost) criteria of section 3622(b). This process involves weighing potentially conflicting factors to reach a fair and equitable rate level proposal. This process is inherently judgmental and therefore cannot be described in a formulaic manner. The Act gives the Commission sufficient discretion to consider "public interest considerations" and to consider potential "tradeoffs designed to address these public interest issues." PRC Op., Docket No. R2001-1 at 46. The Postal Service's rate level proposal is based on witness Potter's judgment that the circumstances surrounding the escrow requirement and the need to recover the escrow through an increase in the Postal Service's revenue requirement were best met through an across-the-board increase in rates and fee. My testimony describes how this approach is consistent not only with the section 3622(b)(3) requirement that attributable costs are covered but also with the other eight pricing criteria.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

c.

- (i) No. Section 3622(b)(3) requires that the revenue resulting from each subclass be sufficient to cover the direct and indirect costs of that subclass. While there is a relationship between the requirement that revenue cover costs on a subclass basis, and the individual proposed rates, the pricing criteria – including criterion 3 – are applied at the subclass level not at the level of the individual rates.
- (ii) I would agree that the term “cost-based rates” could be used to refer to rates for any product which are based upon the costs of that product plus some markup over those costs. However, I would disagree with the implication that “cost-based rates” is a complete description of postal rates and fees developed under the pricing criteria of the Postal Reorganization Act.

Congress did not limit pricing considerations under the Postal Reorganization Act to the construction of “cost-based” rates. Individual pricing criterion, examined in isolation, could be used to argue that the Postal Reorganization requires not only “cost-based rates” (criterion 3); but, also, “value-based rates” (criterion 2), “rates based on operational requirements” (criterion 6); or “social policy-based rates” (criterion 8). While consideration of costs is important – and the Postal Service’s

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

proposal in this case meets the cost coverage requirements of criterion 3 – it is not the only criterion specified in the Act. The Postal Service in its proposal and the Commission in its recommendation must balance all nine pricing criteria to meet the objective of a rate structure that not only results in rate levels that cover costs at the subclass level but also meets the other objectives set out in the Postal Reorganization Act.

- (iii) The Postal Service's goal in designing rates is to reflect the costs of providing mail services, to encourage specific customer behavior, and to offer customers alternatives that meet their needs in ways that are consistent with the pricing criteria of the Act. While efficiency in operations is a goal of the Postal Service, it is not the sole goal of rate design and may conflict with other statutory requirements. For example, the requirement that rates for Media Mail and Library Mail do not vary with distance may not be consistent with the full recognition of costs; however, it is required by the statute. Similarly, social policy considerations affecting preferred classes of mail may result in rates that are lower than those that would result from a purely efficiency-driven approach to rate design. Lastly, some rate elements such as nonmachinable surcharges are designed to compensate the Postal Service for a portion of the costs of

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

handling less efficient mail. However, in some instances, the full cost differentials between machinable and nonmachinable mail have not yet been recognized due to consideration of other factors including the mitigation of the effect on customers.

- d. This question assumes a hypothetical regarding not only the outcome of this case but also the Postal Service's approach to pricing and classification in a subsequent case as well as an assumed pattern of cost changes between Docket No. R2001-1 and the next case following Docket No. R2005-1. I am not able to offer testimony regarding the Postal Service's proposals in any future rate case:

- (i) I cannot predict what mailers will see when the Postal Service files its next omnibus rate request.
- (ii) Confirmed. See, for example, the transcript of the "Rate Making Summit" May 28, 2002 and June 27, 2002; available on the PRC website.
- (iii) To clarify, my testimony on page 20, lines 15-16 states:

As witness Taufique (USPS-T-28) explains, the across-the-board approach does not use the same approach to rate design that is traditionally employed.

USPS-T-27 at 20, lines 15-16.

Otherwise, I am not able to predict what the next omnibus rate request may contain or how it may be viewed.

- (iv) It is beyond the scope of my testimony to speculate about how some rate increases in the next omnibus rate case may be viewed in relation to any preconceived "desired rate positions."
- (v) I would expect, that in any subsequent rate proposal, as has been the case in the preparation of this proposal and previous proposals, that the Postal Service will need to balance (1) the need to meet a revenue requirement; (2) rate relationship and rate design considerations; (3) cost coverage issues; (4) operational requirements; and, (5) product design and classification issues. While certainly not easy, as was done in this case (and described in my testimony), this will be accomplished through the balancing of the pricing criteria in section 3622(b) as well as other relevant statutory provisions of the Postal Reorganization Act. See also the response to (iv).

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-9.

Please refer to your statement on page 9, beginning on line 1, of your testimony, USPS-T-27:

While some may view the decision to use an across-the-board approach as a missed opportunity to re-open long-standing debates over rate design, classifications, and costing proposals, this view would inaccurately characterize where we would be now if the escrow obligation did not exist.

- a. Is it your view that the interests of parties intervening in Commission proceedings can be fairly characterized essentially as not wanting to miss an "opportunity to re-open long-standing debates"? Please explain.
- b. Is it your view that the process of review and examination that occurs before the Commission can be fairly characterized essentially as one of debating issues, many of which are of long standing? Please explain.
- c. Do you think it likely that some of the parties intervening before the Commission are interested in examining and requesting proper recognition up-to-date costs for the subclasses they use? Please explain.
- d. Do you think it would be reasonable for parties intervening before the Commission to be concerned if an opportunity were lost to update Postal Service costs and to assess the extent to which the rates they pay are appropriately based on those costs? Please explain.
- e. Do you view an opportunity lost because a rate case is filed in an across-the board approach as essentially the same (and as of equal moment) as an opportunity lost when a case is not filed at all? Please explain.

RESPONSE:

- a. It is my view that parties intervening before the Commission do so because they are interested in providing guidance to the Commission on potential rates and classifications that would likely be beneficial to those parties' economic interests. This generally results in similar issues concerning rate design, classifications, and costing being discussed

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

before the Commission in a series of rate cases. I do not view parties' interventions to be for the sole purpose of engaging in debate.

- b. Yes. It is my view that the Commission bases its decisions in an omnibus rate case on the record which does include debate over the merits of various positions. Some of these issues have been raised and discussed over a series of omnibus rate cases.
- c. Yes, in past cases, I have testified on rate design for Priority Mail and First-Class Mail. In both those cases, some parties raised costing issues for the Commission's consideration. However, raising a costing issue does not necessarily mean that the advocated position is consistent with "proper recognition [of] . . . costs."
- d. Although the Postal Service has proposed an across-the-board rate increase, the opportunity to "update Postal Service costs" has not been lost in this case. The Postal Service has provided an array of cost studies with its rate request.
- e. Your statement does not appropriately portray the Postal Service's decision to file an across-the-board rate case. Serious consideration was given to the decision to file an across-the-board proposal, including the potential effects on not proposing a variety of rate and classification changes that may otherwise have been proposed. However, the decision to file an across-the-board rate increase hinged on two facts: (1) the Congressionally-mandated escrow obligation; and (2) the reality that, if the

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

escrow obligation did not exist, the Postal Service would not have requested any changes in rates and fees. As explained in my testimony, an across-the-board approach fairly distributes the escrow burden – which is not associated with the provision of any mail product or service – without unduly burdening any one group of customers. The escrow requirement could have been funded through the increase in rates that was disproportionately focused on one or a few subclass. In this example, customers in those subclasses could reasonably have questioned the reasonableness of this allocation – they did not “cause” the escrow requirement and do not differ in that respect from customers who did not face the burden of increased rates. Distributing the escrow burden disproportionately to subclasses with low cost coverages – perhaps those where either the Postal Service or the Commission has previously indicated that it would like to increase the coverage – while possibly appealing, does not address the central concern that prior determinations about appropriate coverages are not associated with the imposition of the escrow requirement.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-11.

Please refer to your response to VP/USPS-T28-17(d), redirected from witness Taufique (USPS-T-28), where you state that "In this example, it is unclear whether you are referring to marginal costs or total costs of providing a product," and, in referring to the response of witness Taufique to VP/USPS-T28-17(c), you state "Therefore, I do not believe, given the break-even constraint and the level of institutional costs, that the pricing of Postal Service products could necessarily result in rates and fees equal to marginal costs for every product."

- a. Please define the term "product" as you use that term in your above-quoted response.
- b. Please refer to your definition of "product" in preceding part a and identify the number of Postal Service products that currently exist in the ECR commercial subclass and, referring to Rate Schedule 322 in the Request, please describe what those products are.

RESPONSE

- a. In my response to VP/USPS-T28-17(d), I use the term "product" as being equivalent to a subclass or special service for which the nine pricing criteria are applied in determining the cost coverage.
- b. One. The entire Standard Mail Enhanced Carrier Route subclass.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-12.

Would you agree that a change in rates described generally as a 5.6 percent “across-the-board” increase represents an approach to setting rates that is both formulaic and unusual? If you do not agree that this is a formulaic approach to rate setting, please explain why not, and define or state what in your opinion would constitute a formulaic approach.

RESPONSE:

I would agree that the Postal Service's proposed 5.4 percent across-the-board increase in rates and fees is “unusual” because the Postal Service has only requested an across-the-board increase in one other docket: Docket No. R94-1.

I would agree also that the proposed 5.4 percent across-the-board rate increase involves calculating proposed rates using a formula, that is,

$$\text{Proposed Rate} = \text{Current Rate} \cdot 1.054$$

with some adjustments based on rounding constraints, statutory requirements associated with Within County Periodicals, and, in the case of Registered Mail and Periodical Applications Fees, to cover costs.

However, I do not agree that this is a “formulaic approach to rate setting.” A formulaic approach to ratemaking would apply the same method to ratemaking regardless of the circumstances surrounding the rate request. Formulas can be applied in rate design without the approach being “formulaic.” Appropriate ratemaking requires that the full context surrounding a rate request be considered and incorporated into the rate proposal. In this case, the Postal Service has considered the full set of circumstances surrounding the rate request

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-12 (continued):

including the facts that if the escrow obligation did not exist a change in rates would not have been requested, and rate relationships and cost coverages would not have been changed. Moreover, the escrow requirement is not associated with the provision of any particular subclass or special service.

The rate request in this docket has been designed to recover the escrow requirement in the most fair and equitable way possible – on a pro rata revenue basis. As discussed in my testimony, other methods could have been used – for example allocation of the escrow burden based on contribution or attributable costs or a judgmental assignment of the escrow burden to individual mail subclasses – but these would have placed the escrow burden disproportionately on some groups of customers in a way that I believe would be unfair and inequitable.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-13.

Please refer to your testimony at page 7 (ll. 9-10), where you state that "While the Postal Service incurs other institutional costs, these other costs, unlike the escrow requirement, are related to the provision of mail services...."

- a. Where you refer here to "the provision of mail services," please explain whether you are referring to the current (or future) provision of mail services, or to the provision of mail services at any and all times in the past?
- b. To the extent that the Postal Service's institutional costs have included retroactive payments to cover workers' compensation costs for injuries incurred prior to enactment of the Postal Reorganization Act, would you consider those costs to be for the provision of mail services? Please explain why a retroactive payment for costs incurred so many years ago should be considered as falling within the ambit of "provision of mail services."
- c. Since the current law now requires the Postal Service to pay all retirement costs for Postal Service employees who have credit for military service, would you consider that portion of retirement costs related to military service to be for the provision of mail services? Please explain why this particular portion of retirement costs should be considered as falling within the ambit of "provision of mail services," and explain what distinguishes this expense from the institutional overhead expense imposed by the escrow obligation.

RESPONSE:

- a. I am referring to institutional costs included in the test-year cost estimates.

In discussing the costs incurred in association with the provision of mail or postal services as compared to the escrow obligation, I am drawing a distinction between costs associated with the ongoing operations of the Postal Service and the escrow requirement that is not been dedicated to any specific use by Congress. As witness Tayman observed,

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-13 (continued):

The amount of the escrow expense is arbitrarily determined in the sense that it represents the difference between the funding requirement relating to a legitimate estimate of the Postal Service's CSRS obligations and an estimate of these obligations that was determined to be substantially in error." USPS-T-6 at 12, lines 4-8.

b. – c.

As discussed above, I would consider costs incurred for the ongoing operation of the Postal Service to be "related to the provision of postal services" as I define that term in the response to part a. While accounting principles and, in the case of the escrow obligation, Public Law 108-18 (discussed by witness Tayman, USPS-T-6) govern the treatment of specific costs and their inclusion in the test-year, for the purposes of this discussion, I am not referring to the provision of mail services in any specified period. The distinction I am making between these costs and the escrow obligation is that the escrow obligation has not been dedicated to any specific use by Congress.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-14.

Please refer to your testimony at page 6 (ll. 19-20) where you state that "postal management was faced with the question of how to **most equitably** recover the escrow burden in a circumstance where they would not otherwise be proposing changes in rates and fees." (Emphasis added.) Please also refer to your testimony at page 8 (ll. 11-12) where you state that "[a]llocating the escrow obligation *pro rata* based on revenue spreads the burden of the escrow requirement **equitably**...." (Emphasis added.)

- a. Is it your opinion that an across-the-board percentage increase in rates is the most equitable way of recovering an increase in institutional costs?
- b. Is it your opinion that any other set of rate increases not based *pro rata* on revenue would be a less equitable way of recovering either (i) any increase in institutional costs, or (ii) an increase in institutional costs mandated by Congress? Please explain your answer.
- c. Unless your answer to preceding part a is an unqualified affirmative, please indicate whether it is your opinion that an across-the-board percentage increase in rates is the most equitable way of recovering an increase in institutional costs only when the increase is mandated by Congress. If this is your opinion, please (i) explain why obligations mandated by Congress require different treatment, and (ii) opine as to why Congress has not enacted a special subsection under Section 3622(b) to allow the Postal Service and the Postal Rate Commission to deal with this situation, or (iii) explain why the Postal Service, in the absence of such legislation, has take it upon itself to decide that the existing rate-setting criteria in Section 3622(b) of the Postal Reorganization Act are inadequate and different treatment is required.

RESPONSE

- a. No. It is my opinion that the proposed across-the-board increase is the most equitable way to recover this specifically-identified institutional cost – the Congressionally-mandated escrow obligation.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-14 (continued):

b.

- i. No. In past dockets, the Postal Service has proposed and the Postal Rate Commission has recommended the allocation of non-escrow institutional costs on bases other than on an across-the-board basis. I believe this to have been appropriate given the circumstances surrounding those dockets. However, given the circumstances surrounding this docket, I believe that the allocation of the escrow obligation on a pro rata revenue basis to be appropriate.
- ii. No, while I believe the escrow requirement to be unusual and it is not likely that a similar circumstance will arise again; I cannot speculate on all possible future actions of Congress. Compared to prior Congressional actions, the escrow requirement is unique in that it is not associated with the ongoing operations of the Postal Service, and it has not been dedicated to any specified purpose. In past instances, for example the OBRAs of the early 1990s, Congressionally-mandated changes in Postal Service costs were addressed through a more conventional rate approach. Generally, I would expect that to be the case in most instances. However, the treatment of any new burdens will certainly merit a full and

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-14 (continued):

independent judgment based on the particular facts underlying the specific circumstance.

- c. No. While I cannot provide a specific example, it is possible that, at some point in the future, an across-the-board percentage increase would be an appropriate way to recover some institutional cost burden that was not mandated by Congress. However, I would expect such an occurrence to be infrequent. The specific circumstances surrounding such a cost would need to be examined to make such a determination. While the pricing criteria of section 3622(b) do not address every particular circumstance that could possibly arise in postal ratemaking, it does provide sufficient flexibility to address many different circumstances including the escrow obligation. The Postal Service has not decided that the existing rate-setting criteria are inadequate; we have determined that under the current circumstances that an across-the-board increase is appropriate based on an evaluation of the pricing criteria.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-15.

Please refer to your testimony at page 12 (ll. 15-18) where you state: Because the escrow expense does not vary with mail volume, and, in fact, is not related to the provision of postal services, it would be unreasonable to propose that any one customer or group of customers bear a disproportionate share of this expense.

- a. Can you identify any institutional overhead expenses that vary with volume? Unless your answer is an unqualified negative, please identify each such expense.
- b. Has the Postal Service made any attempt to identify other expense items in its annual budget that may not be related to the provision of postal services?
- c. Would you agree that having Standard ECR mailers pay a 244.1 percent coverage, while, for example, Standard Regular mailers pay a 159.6 percent coverage and Periodicals within county mailers pay a 104.3 percent coverage, results in Standard ECR mailers bearing a "disproportionate share of this expense?" If not, please explain.
- d. Why is it reasonable to propose that any one customer, or group of customers, bear a disproportionate share of the Postal Service's institutional overhead expense, as the Postal Service has proposed in prior omnibus rate cases?

RESPONSE

- a. No. It is my understanding that the intent of the attribution process is that institutional costs do not vary with volume.
- b. Yes. As discussed in my response to VP/USPS-T 27-13, I am using the phrase "provision of postal services" in a very broad sense to include all costs associated with the ongoing operation of the Postal Service. I recognize that, in some contexts, the term "postal services" has a narrower definition. It is my understanding that the annual budget includes all operating costs and projected revenues for the Postal Service.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-15 (continued):

- c. – d. The fact that cost coverages differ between subclasses and special services is not related to the escrow burden. As USPS-LR-K-114 indicates, the Postal Rate Commission has recommended (and the Postal Service has proposed, for that matter) different cost coverages based upon its view of the pricing criteria and the particular circumstances. That occurred without the escrow requirement.

Witness Potter has stated that this rate increase proposal will be withdrawn if the escrow obligation is removed. Therefore, we have designed this increase to do two things: (1) recover the escrow requirement in the most fair and equitable way possible, and (2) recognize that the current rates and rate relationships would be maintained in the absence of escrow requirement.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-17.

Please refer to your testimony in Section IV.B, starting at page 13 (l. 15) where you discuss the Value of Service criterion contained in Section 3622(b)(2) of the Postal Reorganization Act. Aside from your explanation of the various factors that have been used to assess value of service, please explain how you explicitly took into account value of service when recommending (or reviewing) coverages for each class and subclass of mail, and how that consideration caused you either to increase or decrease the coverage on any individual class or subclass of mail. If the circumstances of this case caused you essentially to ignore, or override considerations of value of service, please so state.

RESPONSE

In this case, the Postal Service was faced with the need to recover an escrow obligation that does not depend on the value of service associated with any particular class of mail. The escrow requirement has been Congressionally-mandated and there is no indication that higher value of service or lower value of service mail classes were intended to bear a greater or lesser share of the escrow burden. Consequently, it was not appropriate to allocate this unique cost on the basis of the relative value of service. Value of service was considered and is incorporated in the proposed rates through the cumulative judgments of the Postal Rate Commission regarding value of service of the specific mail classes. In this instance, it is not correct to say that value of service considerations were ignored, they were not. However, consideration of the unique nature of the escrow expense suggests that differential allocation of the escrow expense based on value of service was inappropriate.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-18.

Please refer to your testimony at page 18 (ll. 6-7) where, in your discussion of Criterion 4, Effect of Rate Increases, you state that "Public Law 108-18 does not differentiate between customers in the imposition of the escrow."

- a. Did the Omnibus Budget Reconciliation Act of 1990 differentiate between postal customers?
- b. Did the Omnibus Budget Reconciliation Act of 1993 differentiate between postal customers?
- c. Did the Balanced Budget Act of 1997 differentiate between postal customers?
- d. Did the section of Public Law 108-18 that requires the Postal Service to pay Civil Service Retirement System ("CSRS") retirement benefits for military service differentiate between postal customers?
- e. Does your above-quoted statement mean that you felt it was necessary for Public Law 108-18 to differentiate between postal customers on the basis of the number of available alternatives in order for you to give explicit consideration and weight to this criterion in Section 3622(b)? If this is not a correct interpretation of what you intended, please explain what you meant.
- f. In light of the criteria already contained in Section 3622(b) of the Postal Reorganization Act, please explain why any act of Congress that imposes some kind of financial obligation on the Postal Service also should contain explicit provisions that differentiate between postal customers.

RESPONSE

- a. No.
- b. No.
- c. No.
- d. No.
- e. This is not a correct interpretation of my statement. If Congress had included specific direction as to how the escrow burden was to be allocated based on the number of available alternatives, then the Postal

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-18 (continued):

Service would have proposed rates that complied with this direction.

However, because this direction was not included in Public Law 108-18, the Postal Service has the discretion to propose rates that are consistent with the pricing criteria. The current proposal to recover the escrow requirement based on an across-the-board increase in rates is consistent with the pricing criteria and does reflect a consideration of each of the criteria. While I am not an expert on all of the provisions of the four acts listed in parts a – d of this question, it is my understanding that each of these acts were specific in terms of the obligations placed upon the Postal Service and imposed some costs associated with the Postal Service or Post Office Department activities and administration. This is fundamentally different from the escrow obligation which is unrelated to the current or past operation and administration of the Postal Service or Post Office Department.

- f. I do not believe that Congress is obligated to include provisions which differentiate between postal customers in any act of Congress. However, to the extent that such provisions are included in statute, the Postal Service will reflect those requirements in its rate proposals.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-19.

Please refer to your testimony at page 19 (ll. 15-16) where you discuss available alternatives, and state that "Public Law 108-18 has not differentiated customers on the basis of the number of available alternatives."

- a. Did the Omnibus Budget Reconciliation Act of 1990 differentiate postal customers on the basis of the number of available alternatives?
- b. Did the Omnibus Budget Reconciliation Act of 1993 differentiate postal customers on the basis of the number of available alternatives?
- c. Did the Balanced Budget Act of 1997 differentiate postal customers on the basis of the number of available alternatives?
- d. Did the section of Public Law 108-18 that requires the Postal Service to pay CSRS retirement benefits for military service differentiate between postal customers on the basis of the number of available alternatives?
- e. Does your above-quoted statement mean that you felt it was necessary for Public Law 108-18 to differentiate customers on the basis of the number of available alternatives in order for you to give explicit consideration and weight to this criterion in Section 3622(b)? If this is not a correct interpretation of what you intended, please explain what you meant.
- f. Please explain how you explicitly took available alternatives into account, especially changes and developments in available alternatives since Docket No. R2001-1, when recommending the coverages for each individual class or subclass of mail. If the circumstances of this case caused you to ignore, or override considerations of available alternatives, please so state.

RESPONSE:

- a. No.
- b. No.
- c. No.
- d. No.
- e. This is not a correct interpretation of my statement. If Congress had included specific direction as to how the escrow burden was to be

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-19 (continued):

allocated based on the number of available alternatives, then the Postal Service would have proposed rates that complied with this direction. However, because this direction was not included in Public Law 108-18, the Postal Service has the discretion to propose rates that are consistent with the pricing criteria. The current proposal to recover the escrow requirement based on an across-the-board increase in rates is consistent with the pricing criteria and does reflect a consideration of each of the criteria. . While I am not an expert on all of the provisions of the four acts listed in parts a – d of this question, it is my understanding that each of these acts were specific in terms of the obligations placed upon the Postal Service and imposed some costs associated with the Postal Service or Post Office Department activities and administration. This is fundamentally different from the escrow obligation which is unrelated to the current or past operation and administration of the Postal Service or Post Office Department. The current proposal to recover the escrow requirement based on an across-the-board increase in rates is consistent with the pricing criteria and does reflect a consideration of each of the criteria.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-19 (continued):

- f. The effect of the number of available alternatives was considered to be incorporated in the current rates through the cumulative application of the pricing criteria embodied in the current rates. In the absence of the escrow requirement, the Postal Service would not have proposed a change in rates and fees and thus would not have incorporated any assessment of the changes in available alternatives. In preparing this rate proposal, I discussed the pricing criteria with management and weighed the issues that you are raising. However, on balance, a policy determination was made that the need to recover the escrow requirement supported an across-the-board proposal. The requirement to reflect the number of available alternatives is designed, in part, to provide protection for customers who for statutory or other structural reasons have few options to using the Postal Service. Since 2001, there have been relatively few changes in the number of available alternatives, most of the changes that have occurred (e.g., increasing ability to use electronic substitutes for mail) have tended to increase the number of available alternatives suggesting that these customers are not always as reliant upon the mails as they were formerly.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-20.

Please refer to your testimony at page 6 (l. 13) where you state that "the escrow obligation does not serve a 'postal' function."

- a. Please define what you mean by the term "postal function" as you use it here.
- b. Please explain how retirement payments for military service serve a "postal" function.
- c. Please explain how workers' compensation expenses for injuries incurred prior to 1971 serve a "postal" function.

RESPONSE:

- a. –c A postal function in this context refers to expenses associated with the ongoing operation of the Postal Service as described in the response to VP/USPS-T27-13. Retirement expenses arise from the provision of mail services and the administration of the Postal Service. These expenses arise from Congress's determination that the Postal Service is obligated to fund these expenses. The escrow requirement differs from these other costs in that it has not been dedicated to any specific use by Congress.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-21.

Please refer to your response to VP/USPS-T27-3(k) where you state: Efforts to force fit past coverages to a new case can only succeed if one is compelled to ignore all new information and solely dwell on the past.

- a. Would you agree that an across-the-board rate increase is built solely on prior rates already in existence? Please explain any disagreement.
- b. Would you agree that an across-the-board rate increase ignores all new information as regards changes in cost, demand, competition, elasticities of demand, etc. Please explain any disagreement.

RESPONSE:

- a. No. The across-the-board increase proposed in this case incorporates an evaluation of the escrow obligation and an assessment of the way to recover this obligation that most appropriately recovers this cost consistent with the nine ratemaking criteria of the Act. It is built on the current rates; however, these rates were not the sole consideration in proposing the across-the-board rate increase.
- b. No. I do not agree that this across-the-board increase ignores all new information. The determination that an across-the-board increase was appropriate involved a weighing of other possible rate proposals involving different rate increases for individual classes of mail. However, this evaluation resulted in the determination that an across-the-board increase was the most appropriate proposal because (1) no rate change would have been proposed absent the escrow requirement, (2) the Postal Service would withdraw the request if Congress acted to remove the escrow requirement and (3) the escrow requirement is not dedicated to

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-21 (continued):

funding any function undertaken by the Postal Service. Please see, also, the
responses to VP/USPS-T27-18 and VP/USPS-T27-19.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-22.

Please refer to your response to VP/USPS-T27-7 where, as part of your response, you state:

The potential for Congressional action removing the escrow requirement must be considered. The proposed across-the-board rate increase permits the Commission to separate the escrow obligation from other issues in rate design that would not otherwise be raised by the Postal Service.

- a. If the Postal Service, the Commission and mailers are to consider the potential for Congressional action removing the escrow requirement, should they also consider the potential for Congressional action eliminating future rate cases and thereby causing rates resulting from your proposed across-the-board increase becoming the basis for rates in the foreseeable future?
- b. In your opinion, is the potential for Congressional inaction a possibility that also should be considered?
- c. With respect to your statement that the proposed across-the-board rate increase permits the Commission to separate the escrow obligation from other issues in rate design, does Public Law 108-18 or the Postal Reorganization Act mandate that the Commission make such a separation?
- d. With respect to your statement that the proposed across-the-board rate increase permits the Commission to separate the escrow obligation from other issues in rate design, does Public Law 108-18 or the Postal Reorganization Act in any way obligate the Commission to make such a separation?
- e. With respect to your statement that the proposed across-the-board rate increase permits the Commission to separate the escrow obligation from other issues in rate design, does the Postal Reorganization Act allow the Commission to make such a separation, and then apply the criteria in Section 3622(b) differentially, to the point of virtually ignoring most of the criteria?

RESPONSE

- a. There are many possible courses Congress could undertake in pending legislation. However, while it would not be unreasonable to consider the range of possibilities, any specific Congressional action is not assured. It does not seem reasonable to anticipate a specific future Congressional action

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-22 (continued):

- ~~b.~~ to address the escrow requirement that will affect a fiscal year which begins in less than four months.
- b. ~~e.~~ Yes. The across-the-board proposal provides a way that the Postal Service can reasonably recover the escrow costs in the event that Congress does not act to remove this obligation.
- c. ~~d.~~ No. Public Law 108-18 and the Postal Reorganization Act do not mandate the Postal Rate Commission to take any specific action regarding the incorporation of the escrow obligation into rates. However, as discussed in my testimony, I believe the Postal Service's proposed across-the-board rate increase proposal approach is consistent with the requirements of both P. L. 108-18 and the PRA.
- d. ~~e.~~ No. Public Law 108-18 and the Postal Reorganization Act do not obligate the Postal Rate Commission to take any specific action regarding the incorporation of the escrow obligation into rates. However, as discussed in my testimony, I believe the Postal Service's proposed across-the-board rate increase proposal approach is consistent with the requirements of both P. L. 108-18 and the PRA.
- e. ~~f.~~ The Postal Reorganization Act allows the Commission to apply its discretion in allocating the institutional costs of the Postal Service to mail products and services. In this case, I believe that the application of an across-the-board increase to recover the escrow obligation is consistent with the pricing criteria

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-22 (continued):

of section 3622(b). The use of an across-the-board increase does not
"virtually ignore" the pricing criteria; rather it recognizes that the unique nature
of this obligation – which is not driven by any postal operation – cannot be
differentially assessed to individual mail classes.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T27-23.

- a. Please confirm that your testimony does not contain or discuss either markups or coverage of individual subclasses using PRC attributable costs. If you do not confirm, please indicate where in your testimony these data can be found.
- b. Please confirm that the markups for individual subclasses using PRC attributable costs can be found only in USPS-LR-K-114, which is a Category 5 library reference, and which you do not sponsor. If you do not confirm, please explain.
- c. Please confirm that, using PRC attributable costs, library reference USPS-LR-K-114 indicates that both (i) Within County Periodicals and (ii) Media Mail and Library Mail have negative markups — *i.e.*, coverages of less than 100 percent — which means that neither subclass covers its attributable costs. If you do not confirm, please explain.
- d. When you prepared your testimony, did you refer to library reference USPS-LR-K-114?
- e. Is it your recommendation that the Commission should approve rates that are known to you to be less than attributable cost?

RESPONSE:

- a. Confirmed except to the extent that Table 3 at page 24 presents markup indices using the Postal Rate Commission costing methodology from Docket No. R2001-1.
- b. Confirmed. See also my response to MMA/USPS-T27-1.
- c. Confirmed, using the Postal Rate Commission costing methodology.
- d. Yes.
- e. No. It is my proposal that the Postal Rate Commission recommend rates that cover costs based on the Postal Service's estimated costs on record in this proceeding. In all cases, using the Postal Service's costing methodology, the proposed rates and fees cover costs in the test-year-after-rates. Exhibit

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.
AND VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T27-23 (continued):

USPS-27B. As noted in my testimony, I have proposed rate increases for Registered Mail and Periodicals Application Fees that are in excess of 5.4 percent solely because these products could not cover costs using the Postal Service's costing methodology.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO VAL-PAK INTERROGATORY REDIRECTED FROM WITNESS THRESS**

VP/USPS-T7-4.

- a. Please refer to your testimony at Table 1 (USPS-T-7, p. 9). Please confirm the that the following volumes for Standard (Commercial) ECR mail are correctly indicated in Table 1:

<u>Year</u>	<u>Volume (millions of pieces)</u>
Base Year 2004	30,345.448
Test Year 2006 (Before Rates)	33,328.906
Test Year 2006 (After Rates)	32,187.100

- b. Please refer to your testimony (USPS-T-7) at page 100 (II. 19-23) which states:

The Test Year before-rates volume for Standard ECR is 33,328.906 million pieces, a **9.8 percent increase** from GFY 2004. The Postal Service's proposed rates in this case are predicted to **reduce** the Test Year volume of Standard ECR mail by **3.4 percent**, for a Test Year after-rates volume forecast for Standard ECR mail of 32,187.100 million. [USPS-T-7, p. 100, II. 19-23, emphasis added.]

Please confirm that the Postal Service's proposed rate increase for Standard (Commercial) ECR mail of 5.6 percent in the present case is predicted to result in **lost volume of 1,141.806 million pieces** (*i.e.*, 33,328.906 less 32,187.100), or a decrease of 3.4 percent, of Standard (Commercial) ECR mail in Test Year 2006.

- c. The total volume of Standard (Commercial) ECR mail (see part a above) and Standard Nonprofit ECR mail for Test Year 2006 after-rates is as follows:

	<u>Volume (millions of pieces)</u>
Standard (Commercial) ECR	32,187.100
Standard Nonprofit ECR	<u>3,128.857</u>
Total	35,315.957

Witness Robinson (USPS-T-27), in Exhibit USPS-27B of her testimony, indicates that the contribution of Standard (Commercial) ECR mail and Standard Nonprofit ECR mail is \$3,575,995,000, or 10.13 cents per unit (*i.e.*, \$3,575,995,000 / 35,315,957,000 = \$0.1013 per unit).

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF VALPAK REDIRECTED FROM WITNESS THRESS**

VP/USPS-T7-4 (continued):

Please confirm that the reduction in volume that you project of 1,141.806 million pieces of Standard (Commercial) ECR mail corresponds to a **decrease of about \$115,616,081** in the contribution from Standard (Commercial) ECR mail from that lost volume. If you cannot confirm, please state the lost contribution from this lost volume.

RESPONSE:

- a. Response provided by witness Thress.
- b. Response provided by witness Thress.
- c. Note – the following response incorporates the revisions included in POIR No. 4

Question 7 and errata to Exhibits USPS-T27A and USPS-T27-B.

Confirmed that, for the test-year-after-rates

- The total volume of Standard Mail ECR and Nonprofit ECR is 35,315,957,000 pieces.
- The Standard Mail ECR and Nonprofit ECR contribution is \$3,575,988,000 (Exhibit USPS-27B as revised.)
- The unit contribution for Standard Mail ECR and Nonprofit ECR is 10.13 cents per piece.
- The reduction in the Standard Mail ECR volume between the test-year-before-rates and the test-year-after-rates is 1,141,806,000 pieces.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF VALPAK REDIRECTED FROM WITNESS THRESS**

RESPONSE to VP/USPS-T7-4c (continued):

Not confirmed that the reduction in Standard Mail ECR volume results in a contribution loss of \$115,615,855 = (reduction in volume) * (average contribution per piece).

Your calculation portrays the sole result of a price-driven volume decline as a contribution loss while ignoring that the net result of the price increase is an increase in contribution from Standard Mail ECR and NECR. This ignores the fact that the Standard Mail ECR and NECR price increase, while resulting in a volume decrease, has the net result of increasing contribution by approximately \$205 million.

The Postal Service estimates volume changes from proposed rate changes to allow the projection of the overall financial impact of the rate change and the net change in contribution from the rate change. Attempting to allocate the change in contribution into "buckets" by disaggregating the simultaneous effect on contribution of a price increase and a volume decrease into component parts suggests an independence between the volume reduction and the price increase that does not exist.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF VALPAK REDIRECTED FROM WITNESS THRESS**

VP/USPS-T7-5.

- a. Please refer to your testimony at Table 1 (USPS-T-7, p. 9). Please confirm that the following volumes for Standard (Commercial) Regular mail are correctly indicated in Table 1:

<u>Year</u>	<u>Volume (millions of pieces)</u>
Base Year 2004	50,776.236
Test Year 2006 (Before Rates)	56,985.773
Test Year 2006 (After Rates)	56,478.638

- b. Please refer to your testimony (USPS-T-7) at page 94 (ll. 22-26), which states:

The Test Year before-rates volume for Standard Regular mail is 56,985.733 million pieces, a **12.2 percent increase** from GFY 2004. The Postal Service's proposed rates in this case are predicted to **reduce** the Test Year volume of Standard Regular mail by **0.9 percent**, for a Test Year after rates volume forecast for Standard Regular mail of 56,478.638 million. [USPS-T-7, p. 94, ll. 22-26, emphasis added.]

Please confirm that it is estimated that the Postal Service's proposed rate increase for Standard (Commercial) Regular mail of 5.6 percent in the present case will result in a **decrease of 507.135 million pieces** of Standard (Commercial) Regular mail in Test Year 2006 (*i.e.*, 56,985.773 less 56,478.638).

- c. The total volume of Standard (Commercial) Regular mail and Standard Nonprofit Regular mail for Test Year 2006 after-rates is as follows:

	<u>Volume (millions of pieces)</u>
Standard (Commercial) Regular	56,478.638
Standard Nonprofit Regular	<u>12,289.469</u>
Total	68,768.107

Witness Robinson (USPS-T-27), in Exhibit USPS-27B of her testimony, indicates that the contribution of Standard (Commercial) Regular mail and Standard Nonprofit Regular mail is \$5,434,229, or 7.9 cents per unit (*i.e.*, \$5,434,229,000 / 68,768,107,000 = \$0.079 per unit). Please confirm that the reduction in volume that you project of 507.135 million pieces of

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF VALPAK REDIRECTED FROM WITNESS THRESS**

VP/USPS-T7-5 (continued):

Standard (Commercial) Regular mail corresponds to a **decrease of about \$40,075,085** in the contribution from Standard (Commercial) Regular mail. If you cannot confirm, please state the lost contribution from this lost volume.

RESPONSE:

- a. Response provided by witness Thress.
- b. Response provided by witness Thress.
- c. Note – the following response incorporates the revisions included in POIR No. 4

Question 7 and errata to Exhibits USPS-T27A and USPS-T27-B

Confirmed that, for the test-year-after-rates

- The total volume of Standard Mail Regular and Nonprofit is 68,768,107,000 pieces.
- The Standard Mail Regular and Nonprofit contribution is 5,434,297,000(Exhibit USPS-27B as revised.)
- The unit contribution for Standard Mail Regular and Nonprofit is 7.90 cents per piece.
- The reduction in the Standard Mail Regular volume between the test-year-before-rates and the test-year-after-rates is 507,135,000 pieces.

Not confirmed that the reduction in Standard Mail Regular volume results in a contribution loss of \$40,075,583= (reduction in volume) * (average contribution per piece).

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF VALPAK REDIRECTED FROM WITNESS THRESS**

RESPONSE to VP/USPS-T7-5c (continued):

Your calculation portrays the sole result of a price-driven volume decline as a contribution loss while ignoring that the net result of the price increase is an increase in contribution from Standard Mail Regular and Nonprofit. This ignores the fact that the Standard Mail ECR and NECR price increase, while resulting in a volume decrease, has the net result of increasing contribution by approximately \$690 million.

The Postal Service estimates volume changes from proposed rate changes to allow the projection of the overall financial impact of the rate change and the net change in contribution from the rate change. Attempting to allocate the change in contribution into "buckets" by disaggregating the simultaneous effect on contribution of a price increase and a volume decrease into component parts suggests an independence between the volume reduction and the price increase that does not exist.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK
REDIRECTED FROM WITNESS TAUFIQUE

VP/USPS-T28-17. Please address the following questions relating to costs, economic efficiency, and competition:

- d. Please assume that there are no cross elasticities and that all own-price elasticities are at the same non-zero level. Now consider two markup measures: Measure A is the per-piece (unit) markup, as in the rate being 6 cents above cost, and Measure B is the percentage markup, as in rates being 30 percent above cost (implying a cost coverage of 130 percent).
- (i) If one were interested in improving the efficiency of resource allocation and in reducing losses in economic efficiency, please explain which of the two measures would be most useful in gauging the distance of the rates from their costs, *i.e.*, which measure of distance-above-costs is indicative of the efficiency loss associated with the rate?
 - (ii) Under the elasticity assumptions of this question, would you agree that all rates should have the same percentage markup, but not the same per piece markup. If you do not agree, provide references to the economic literature supporting your position.
 - (iii) Please explain whether you agree that, even if the elasticity assumptions are relaxed and the efficiency formulas become more complex, it is still measure B and not measure A that has a reasonably simple and straightforward relation to notions of economic efficiency.
 - (iv) Please explain whether you agree that under notions of economic efficiency, absent externalities and cross elasticities, one could say that the more elastic products would have a lower measure B (cost coverage) but one could not say whether the more elastic products would have a lower measure **A** (per-piece (unit) markup).

RESPONSE:

- d. In this example, it is unclear whether you are referring to marginal costs or total costs of providing a product. Generally, economically efficient pricing exists when price equals marginal cost (assuming total costs are covered). As witness Taufique describes in his response to

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK
REDIRECTED FROM WITNESS TAUFIQUE

(c), this can be problematic, particularly in organizations with substantial network infrastructures. Therefore, I do not believe, given the break-even constraint and the level of institutional costs, that the pricing of Postal Service products could necessarily result in rates and fees equal to marginal costs for every product. Nevertheless, the Reorganization Act does not require that postal prices be economically efficient, it requires that prices be established that are consistent with the nine, section 3622(b), pricing criteria, several of which require consideration of factors that could run counter to purely economically efficient rates.

- (i) In evaluating economic efficiency, a markup measure based on a percentage may be simpler to use than a markup measure based on calculating the lump sum, cents-per-piece markup. However, the amount of efficiency loss would depend on the amount by which the price deviates from the marginal costs, not on whether this difference is measured on a lump sum basis or on a percentage basis.
- (ii) No. The Commission is required to recommend rates based on the nine pricing criteria. Application of these criteria can and has resulted in rate recommendations with varying markups (cost coverages.) As the Commission noted in Docket No. R2000-1, "Economic efficiency is neither the exclusive nor even

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK
REDIRECTED FROM WITNESS TAUFIQUE

the paramount ratemaking objective under the Act.” PRC Op.

Docket No. R2000-1 at 210.

- (iii) See my response to part (i).
- (iv) Under certain assumptions, economic efficiency increases if markups measured on a percentage basis increase as own-price elasticity decreases in absolute value. The same claim cannot be made for a markup measured on a “lump sum” or per-piece basis.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORIES OF VALPAK
REDIRECTED FROM WITNESS TAUFIQUE

VP/USPS-T28-18.

Please refer to the following statement from the Commission's *Opinion and Recommended Decision* in Docket No. MC95-1, pages V-161-62, ¶ 5388, in reference to a separate automation subclass of Standard Mail:

The alternative of creating separate subclasses and considering the issue of lowest combined cost when selecting the associated markups is not a rational alternative. Selecting the markups in such a constrained way provides rates that are no different from those that result from offering worksharing discounts through rate categories. . . . One has to question the logic of creating subclasses and then constraining the outcome in accordance with a result that would be obtained without creating the subclasses.

- a. Please explain whether the cost coverages of the current ECR and Regular Standard subclasses, whose relative levels are being perpetuated by the across-the-board proposal, are or should be constrained in any way to achieve "a result that would be obtained without creating the subclasses."
- b. Has the Postal Service done any analysis to determine whether the proposed ECR rates differ from those that would likely exist if ECR had **not** been made into a separate subclass? If so, please provide that analysis.

RESPONSE:

- a. The cost coverages for the Standard Mail Regular and ECR subclasses have not been and should not be constrained "to achieve 'a result that would be obtained without creating the subclasses.'" The Postal Service proposes cost coverages for all subclasses of mail based on the application of the pricing criteria of section 3622(b) of the Postal Reorganization Act.
- b. No.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO VAL-PAK INTERROGATORY REDIRECTED FROM WITNESS TAUFIQUE**

VP/USPS-T28-21. Please suppose the rates for (i) ECR Basic letters and (ii) Regular prebarcoded 5-digit letters (rates also referenced in VP/USPS-T28-20) were based on their costs and a markup rooted in an independent application of the non-cost factors in the Postal Reorganization Act, with an outcome that the ECR Basic rate were lower than the Regular prebarcoded 5-digit rate.

- a. Please explain whether it is the Postal Service's position that an additional layer of rate design guidance should be applied in order to push the ECR Basic rate for letters higher so that any mail using the rate is precluded from receiving recognition of its costs and the independent application of the non-cost factors in the Postal Reorganization Act. If this is the Postal Service's position, please explain all reasons and bases for this position.
- b. If the layering described in part a is the Postal Service's position, please explain how it is fair to mailers using the ECR Basic rate, who must accordingly pay higher rates.
- c. Please explain whether the Postal Service sees elevating the cost coverage of the ECR subclass as one way to help achieve a rate for ECR Basic letters that is higher than the rate for Regular prebarcoded 5-digit letters. If so, please explain the basis for this higher coverage and how it is fair to mailers of other letters using the ECR subclass, to ECR mailers of non-letters, and to mailers of all Nonprofit ECR materials.
- d. Within the confines of a specific cost coverage for the ECR subclass, please explain whether the Postal Service agrees that any process of elevating the ECR Basic letter rate at the same time necessarily has the effect of providing lower rates for the non-letters in ECR. If it does agree, please discuss and explain the basic economic fairness of elevating letter rates in a way that provides lower rates to non-letters. If it does not agree, please explain the steps that are taken, and the steps that should be taken, to make it otherwise.
- e. If the Postal Service has an interest in achieving a rate for ECR Basic letters that is higher than the rate for Regular prebarcoded 5-digit letters, please explain why it is not just as logical and just as fair to artificially **lower** the rate for 5 Regular prebarcoded 5-digit letters as it is to artificially **increase** the rate for ECR Basic letters.

RESPONSE

- a. Response provided by witness Taufique.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF VALPAK REDIRECTED FROM WITNESS THRESS**

RESPONSE to VP/USPS-T28-21(c) continued:

- b. Response provided by witness Taufique.
- c. No. The selection of cost coverages for the Standard Mail ECR subclass is based on the application of the nine pricing criteria of Title 39, section 3622(b). While the relative coverages of the subclasses has some effect on the prices within the subclasses, this particular rate relationship has not driven the selection of either the cost coverages for Standard Mail ECR or for Standard Mail Regular in this docket or in previous dockets. As described in my testimony, in this docket, with few exceptions, the Postal Service is proposing a 5.4 percent across-the-board rate increase for the sole purpose of recovering the Congressionally-mandated escrow obligation. See also, the response of witness Taufique to VP/USPS-T27-21a.
- d. Response provided by witness Taufique.
- e. Response provided by witness Taufique.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS ROBINSON
TO INTERROGATORY OF VALPAK REDIRECTED FROM WITNESS THRESS**

VP/USPS-T28-28.

Please refer to USPS-LR-K-115, workbook USPST28Aspreadsheets.xls, and to USPSLR-K-114, the latter showing final "Markups" and "Markup Indices."

- a. On spreadsheets such as "S-7 Comm. Piece-Pound Dist.-BY," please confirm that the volumes shown for "Nonmachinable" letters are shown for purposes of applying the surcharge only and that the same volumes also are included in the corresponding categories of "Presorted" letters. Please explain fully any nonconfirmation.
- b. Please explain whether the "Markups" and "Markup Indices" shown in USPSLR-K-114 include the fees in the revenues used to calculate them. If they do not, please provide a revised reference showing the markups and indices with the fees included.
- c. Please provide a source for each of the percentage figures in columns D and E of the second sheet of USPS-LR-K-114.

RESPONSE:

- a. Response provided by witness Taufique.
- b. The markups and the markup indices are based on the revenue in Exhibit USPS-27B which includes both postage and domestic mail fees.
- c. Column D: Markup: USPS Proposal R2005-1.

Markup = CostCoverage -1

Test-year-after-rates cost coverage: Exhibit USPS-28B, column 3

Column E: Markup: PRC Version R2005-1.

Markup = {[Revenue / Attributable Costs] - 1}.

Revenues: Exhibit USPS-28B, column 2;

Attributable Costs: USPS-LR-K-96, workpaper

R2005.FY2006ARC_DRpt.PRC.AMX, worksheet DReport.

1 MR. TIDWELL: Mr. Chairman, I certainly will. I
2 just want to state for the record that consistent with the
3 discussion that was just had with co-counsel regarding
4 counterdesignations, the Postal Service has included in the
5 packet some designated responses to complete the responses
6 that were filed to ABA-USPS-T-27-1. We have inserted the
7 complete responses. It incorporates subparts C and D.
8 Also, MMA-T-28-1, we have substituted the partial
9 designation with the complete designation, and the same is
10 true of the designated response to GCA-T-1-2 that was
11 redirected from Witness Potter to Witness Robinson.

12 CHAIRMAN OMAS: Without objection.

13 Is there any additional written cross-examination
14 for Witness Robinson?

15 (No response.)

16 CHAIRMAN OMAS: At this point, I'm going to add
17 answers Witness Robinson provided to the presiding officer's
18 information request. They are two answers that were not
19 designated. They are POIR-2, Question 16; and POIR-4,
20 Question 3(b).

21 Witness Robinson, would your answers to those
22 questions be the same as those you previously provided in
23 writing?

24 THE WITNESS: Yes, they would be.

5 CHAIRMAN OMAS: I am handing the reporter two

1 copies of those answers and direct that they be admitted
2 into evidence.

3 (The documents referred to,
4 previously identified as
5 Exhibit Nos. POIR-2, Question
6 16 and POIR-4, Question 3(b)
7 were received in evidence.)

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RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 2, QUESTION 16

16. Please provide the source of mailgrams revenue shown in Exhibits USPS-27A, USPS-27B and USPS-27C.

RESPONSE:

Mailgram revenues shown in Exhibits USPS-27A, USPS-27B, and USPS-27C were calculated as follows:

Calculation of Mailgram Revenue

Base Year FY 2004

	Volume	Revenue	Revenue per Piece
	(a)	(b)	(c) = (b) / (a)
Quarter 1	0.371	0.159	0.429
Quarter 2	0.406	0.173	0.426
Quarter 3	0.491	0.204	0.416
Quarter 4	0.380	0.163	0.430
Total	1.648	0.700	1.702

Interim Year: FY 2005

	Volume	Revenue
	(d)	(e) = (d) * (c)
Quarter 1	0.434	0.186
Quarter 2	0.422	0.180
Quarter 3	0.440	0.183
Quarter 4	0.310	0.133
Total	1.607	0.683

Test Year Before Rates: FY 2006

	Volume	Revenue
	(f)	(g) = (f) * (c)
Quarter 1	0.343	0.147
Quarter 2	0.366	0.156
Quarter 3	0.382	0.159
Quarter 4	0.269	0.116
Total	1.359	0.578

Test Year After Rates: FY 2006

	Volume	Revenue
	(h)	(i) = (h) * (c) * 1.054
Quarter 1	0.343	0.155

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 2, QUESTION 16

Quarter 2	0.366	0.164
Quarter 3	0.382	0.167
Quarter 4	0.269	0.122
Total	1.359	0.609

Sources:

(a) RPW

(d) USPS-T-7 at 348

(f) USPS-T-7 at 350

(h) USPS-T-7 at 354

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

3. The charts below depict the cube-weight relationship for Parcel Select DBMC mail, which is also used as a proxy for DSCF and DDU mail, as developed by the Postal Service for dockets R2001-1 and R2005-1.

- (b) Because the proposed rates are determined by multiplying current rates by 5.4% the underlying cost structure implicitly reflects the cube-weight relationship used in R2001-1. Please discuss the implications of setting rates based on a cube-weight relationship that is clearly different than the actual cube-weight relationship. In particular, discuss the implications on mailers of low-weight parcels, who may be paying a disproportionate share of costs; Postal Service competitors, and overall economic efficiency.
- (c) Please discuss the implications for future rate payers on setting rates that do not reflect the current cube-weight relationship, particularly the possibility of future rate shock for some weight increments of parcel select mail.

RESPONSE:

(b) The proposed 5.4 percent across-the-board rate increase is designed to recover the Congressionally-mandated escrow obligation from customers in a fair and equitable manner based on revenue. As discussed in my testimony, with few exceptions, the Postal Service is proposing an approximately 5.4 percent increase in virtually all rates and fees including Parcel Select rates. As witness Potter explained, the Postal Service, in the absence of the escrow requirement, would not be proposing any changes in rates and fees. Therefore, without the escrow requirement, the current (Docket No. R2001-1) Parcel Select rates would not have changed.

In a traditional rate case, rate design is based on assumptions about the allocation of costs and the relationship of rates to the underlying cost and mail piece characteristics such as the cube-weight relationship in Parcel Select. Over time, changes in these relationships may occur; however, these changes, in and of themselves, do not necessarily result in a Postal Service request to change rates and fees. The decision to request rate and fee changes is based on a comprehensive evaluation of the financial circumstances facing the organization including the revenue

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

requirement, market conditions, operational requirements, and the potential effect of proposed changes on customers and competitors. In this case, the Postal Service determined it would not propose a change in rates and fees if the escrow requirement did not exist

The across-the-board approach to increasing rates and fees in this docket is both fair and equitable, and results in rates that meet all of the pricing criteria of the Postal Reorganization Act. As noted in the question, one option would have been to propose a lower-than-average rate increase for customers who mail low-weight Parcel Select pieces. If this approach had been used, effectively these customers would have borne less of the escrow burden than customers who mail heavier Parcel Select pieces or those who mail using any other class of mail. Because the escrow requirement does not vary depending on cube-weight relationships, with mail volume, and is not based on the provision of any postal service, it would be unreasonable to propose that any of these bases be used to allocate the escrow-related increase in the revenue requirement. Given the lack of association of the escrow requirement with the provision of postal services, I do not believe that it would be fair and equitable to exempt any subclass or portion of a subclass – either partially or totally – from an equal share in this Congressionally-mandated burden. See response to VP/USPS-T27-5(d) and VP/USPS-T27-6(f)(iii).

As discussed in my testimony (USPS-T-27 at 18-19), appropriate pricing for competitive products does not necessarily require that these product always receive the same price increase as less competitive products. However, in this case, which is driven by a Congressionally-mandated escrow requirement, the across-the-board proposal is

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

an indication that the Postal Service has endeavored to propose a rate change that does not unduly harm its competitors.

(c) In proposing any set of rates and fees, the Postal Service considers the effect on customers including the size of the rate change, and any changes in rate relationships. While the observed cube-weight relationship may suggest a direction for Parcel Select rates, this decision should not be made without considering all the circumstances surrounding this relationship. For example, the changes may be driven by transient factors not likely to persist, may reflect a data abnormality, or may actually be indicative of an underlying change in the cube-weight relationship. As described in the response to part a, the change in the Parcel Select cube-weight relationship appears only in the FY 2004 data not in the data for the prior years. Therefore, it is possible the observed change does not reflect a change in the Parcel Select mail characteristics but may only be a temporary, and as of yet unexplained anomaly. Without further study, it is premature to factor this change into the Parcel Select rates.

In a traditional omnibus rate case, all of these factors would be carefully considered and rate design proposed that reflected the results of this analysis. In many cases, both the Postal Service and the Postal Rate Commission have taken conservative approaches to changes in operations or costs to permit an ongoing examination of the relationships that drive rate design. See, for example, the Docket No. R2000-1 treatment of Priority Mail network costs; Docket No. R2000-1, PRC Op. at 311. I would expect that the Commission would continue to take a considered approach

RESPONSE OF POSTAL SERVICE WITNESS ROBINSON TO
POIR NO. 4, QUESTION 3 (b)-(c)

to changes in rate design if it appears that the change in the Parcel Select cube-weight relationship will persist.

1 CHAIRMAN OMAS: This now brings us to oral cross-
2 examination. Three parties have requested oral cross-
3 examination, Greeting Cards Association, Major Mailers
4 Association, and Val-Pak Direct Marketing Systems, Inc., and
5 Val-Pak Dealers Association, Inc. Is there any other party
6 in the hearing room who wishes to cross-examine Witness
7 Robinson today?

8 (No response).

9 CHAIRMAN OMAS: There being none, Mr. Swendiman,
10 would you please begin?

11 MR. SWENDIMAN: Mr. Chairman and members of the
12 Commission, the Greeting Card Association will defer any
13 cross-examination, but we reserve the right for any follow-
14 up that is necessary based on the cross-examination and
15 questions from the commissioners.

16 CHAIRMAN OMAS: Thank you.

17 Mr. Hall, Major Mailers Association.

18 MR. HALL: Mr. Chairman, before we get started
19 here, I have a cross-examination exhibit that I would like
20 to distribute to the witness, the commissioners, and
21 yourself, and I have copies for the reporter and a few
22 additional copies if other parties want them.

23 With your permission, I would like to identify the
24 document and have it marked as an exhibit. It's a one-page
25 document. It indicates it's cross-examination exhibit for

1 USPS Witness Robinson. The title of it is "Implicit
2 Financial Data for Presorted First-Class Mail (PRC
3 Attributable Cost Methodology)." This cross-examination
4 exhibit was provided to the witness and counsel a few days
5 ago, and, at this point, I would like to have it marked as
6 Exhibit No. XEMMA-1 or XE-1, whichever your preference is.

7 CHAIRMAN OMAS: We'll go with XEMMA-1.

8 (The document referred to was
9 marked for identification as
10 XEMMA-1.)

11 CROSS-EXAMINATION

12 BY MR. HALL:

13 Q Good morning, Ms. Robinson. How are you?

14 A Fine, thank you.

15 Q Have you had a chance to look over the cross-
16 examination exhibit that was just identified?

17 A Yes, I have.

18 Q And do you notice that for the R2005-1 case, we
19 have used information developed from your interrogatory
20 responses, specifically, MMA/USPS-T-27-2?

21 A Yes.

22 Q And did we get up to date properly with the
23 revisions that you put in yesterday?

24 A I believe the information for Docket R-90 is
25 incorrect for the unit cost and unit contribution, which

1 also will affect your change calculations, "since R-90," on
2 the last line.

3 Q Could you tell us what you believe are the
4 appropriate figures for that?

5 A For unit revenue, 0.261; unit cost, 0.121; unit
6 contribution, 0.140. On the line change "since R-90," under
7 the "unit revenue" column, 0.059, 23 percent; unit cost, -
8 0.019, which is -16 percent; unit contribution, 0.078, 56
9 percent; cost coverage, 98 percent for the change and a 46
10 percent underneath that; markup index, 39 percent, which is
11 17 percent, which I believe is what you have on your
12 exhibit.

13 Q And the source of our errors that you found?

14 A It was the omission of the carrier route volume in
15 Docket R-90. You had included the 35 presort volume and not
16 the carrier route volumes.

17 Q We did go back and forth on that in several
18 iterations trying to get it right, and we thank you for your
19 corrections.

20 But I guess the number that hasn't changed that I
21 would like you to look at is the cost coverage of 313
22 percent. Is that the highest it's ever been, to your
23 knowledge?

24 A That number is an implicit cost coverage for
5 presorted first-class mail, and, to my knowledge, that is

1 the highest that implicit cost coverage has been.

2 Q And would you term the increase of 98 percent over
3 that period -- would you think that was significant?

4 A An increase of 98 percent would be significant;
5 however, for a full perspective of what that number means,
6 you need to look at it in the context of changes in the cost
7 coverages for other classes of mail.

8 Q Well, do you know of any other class of mail that
9 has exhibited this particular characteristic, an increase in
10 the cost coverage?

11 A I'm not aware specifically of any class of mail.
12 I haven't looked at that. However, I would note that there
13 has genuinely been an increase in the institutional cost per
14 piece, if you include prior year losses from Docket No. R-
15 90, on the order of approximately 60 percent.

16 Q Another portion of the exhibit I would like you to
17 look at is the unit cost, and that has decreased, or been
18 reduced, pretty substantially, hasn't it?

19 A There has been a reduction in the unit cost, but
20 you also need to consider that following Docket No. NC95-1,
21 there were substantial changes in the work-sharing
22 opportunities for first-class mail which may have an impact
23 on that number.

24 Q But in any event, that means more savings for the
25 Postal Service, doesn't it, those changes? Is that what

1 your testimony is?

2 A To the extent that a work-sharing discount
3 represents the level of costs avoided by the Postal Service
4 per customer of doing that work, if that's what you mean by
5 more savings, that is correct.

6 Q Now, would you look at your response to MMA/USPS-
7 T-27-2, Part E? There, we had asked you to explain why the
8 Postal Service's proposed 5.4 percent across-the-board rate
9 increase significantly increases the cost coverage and
10 markup index for first-class mail in this case, and part of
11 your explanation was, just taken, I guess, in a vacuum, the
12 5.4 percent across-the-board increase would have tended to
13 bring the cost coverages and markup indices closer to the
14 average. Is that correct?

15 A If an across-the-board increase of 5.4 percent or
16 any other percentage is applied to a given set of rates,
17 that would tend to move the markup indices towards the
18 average. Cost coverage would tend to increase.

19 Q Okay. And so you explained the increases, in
20 part, by the following statement: "The increases in both
21 the cost coverage and the markup index for first-class mail
22 letters are in large measure the result of successful
23 efforts to control Postal Service costs and may also be
24 affected by changes in the characteristic of first-class
25 mail letters."

1 Now, is this reduction over time in the unit cost
2 of presorted first-class mail one of the -- is that evidence
3 of what you're describing in the statement that I just
4 quoted?

5 A The statement you quoted refers to the first-class
6 mail letters and sealed parcel subclasses in total. For
7 example, there has been a change in the characteristics in
8 that subclass, moving more towards presorted mail, which
9 would have a tendency to increase the cost coverages.

10 Q I guess what I'm honing in on here is the question
11 of the Postal Service's successful effort to control costs.
12 So would the unit cost reductions that we're seeing here on
13 the cross-examination exhibit be a manifestation of that
14 success?

15 A I'm certainly not an expert on costing for first-
16 class mail. It's generally my understanding that the
17 automation program has resulted in costs that were lower
18 than they would have been. Whether that results in an
19 absolute decrease in the level of unit costs I would leave
20 to the costing experts to determine.

21 Q Okay. That's fair. But in any case, we do see
22 the unit costs being reduced over time here.

23 Now, I guess the Postal Service could also save
24 costs to the extent that workshare mailers assume additional
25 duties or responsibilities that were formerly performed by

1 the Postal Service. Would you think that?

2 A In general, the principle underlying the workshare
3 discounts is that a customer would perform activities that
4 otherwise would be performed by the Postal Service, thus
5 reducing the Postal Service's costs and forming the basis
6 for the discount.

7 Q Now, looking at the time period covered by this
8 exhibit, wage rates have gone up throughout this period,
9 haven't they, labor costs?

10 A I'm certainly not an expert on the Postal
11 Service's labor costs, but that seems to be a reasonable
12 assumption.

13 Q And nonetheless, the unit costs for presorted
14 first-class mail have gone down, even in the face of those
15 labor cost increases.

16 A The unit costs have gone down. However, once
17 again, as I'm not an expert on the cost methodologies, you
18 do need to consider there are factors other than labor
19 included in those unit costs.

20 MR. HALL: Okay. First, let me go ahead and ask
21 that the cross-examination exhibit previously identified be
22 accepted into evidence at this point.

23 CHAIRMAN OMAS: Without objection.

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1 (The document referred to,
2 previously identified as
3 XEMMA-1, was received in
4 evidence.)

5 BY MR. HALL:

6 Q Is it fair to say that the Postal Service, in
7 general, and you, in particular, but certainly not
8 exclusively, consider the rate increase in this case to be a
9 special animal, and by that I mean that you have looked at
10 the nature of the costs in question to justify an across-
11 the-board approach to the rate increase. Is that correct?

12 A I think it's been stated in my testimony and the
13 testimony of Witness Potter and other witnesses in this case
14 that the escrow obligation is a very unique cost facing the
15 Postal Service, in that that cost is not associated with the
16 ongoing operations of the Postal Service and has not been
17 designated to any specific purpose. The cost has been
18 congressionally imposed upon the Postal Service, and in
19 facing a decision as to how we were to recover those costs
20 through rates, we've taken a somewhat unusual approach of
21 proposing a 5.4 percent across-the-board increase with very
22 few exceptions.

23 Q Okay. I would like now to read you a part of the
24 response of Witness Taufique to POIR No. 1, Part B, as
5 follows: "The proposed prices are based on the application

1 of a 5.4 percent target increase for each rate category,
2 adhering to rounding conventions for that particular rate
3 category. In a traditional omnibus case, we could
4 potentially reexamine costing methodology and the alignment
5 of discounts, as well as consider potential classification
6 changes. These issues will be reviewed prior to the filing
7 of the next omnibus rate filing. In fact, we will believe
8 it is more appropriate to examine the entire array of
9 discounts at that time."

10 Let me ask you now, referring back to the exhibit
11 which is now in evidence, the change in the cost coverage
12 from 2001 of 266 percent to the 313 percent in this case --
13 in a normal case, one that wasn't special in the way that
14 you've described it, would you expect that the Postal
15 Service would be looking at this unprecedented level of cost
16 coverage for presorted first-class mail?

17 A Generally, in proposing rates and fees for all
18 classes of mail and rate categories, for example, presorted
19 first-class mail, the Postal Service would look at changes
20 in costs and cost coverages and make determinations based on
21 their evaluation of what the appropriate proposal would be,
22 given the pricing criteria of the act.

23 The fact that a cost coverage has increased does
24 not necessarily imply that there would be a guarantee that
5 there would be changes to reduce that cost coverage. The

1 full context has to be considered before we can make a rate
2 proposal.

3 Q But that is one of the items that you would look
4 at.

5 A It's one of the items we would look at; however,
6 there are a number of other items that would be considered
7 as well.

8 Q Right. And you would also look at the markup
9 index in a related way.

10 A Generally, the Postal Service does not refer to
11 markup indices in that the information included in those
12 markup indices are in the cost coverages and any other
13 information underlying the rate design. However, it does
14 provide some information about the relative markups of the
15 various class of mail, and that type of information is
16 examined.

17 Q Okay. I guess, in terms of the proposed discounts
18 for presorted first-class mail in this case, those have also
19 been adjusted by 5.4 percent. Is that correct?

20 A That's my understanding what Witness Taufique has
21 done.

22 Q Right. And despite the increase, would it be fair
23 to say that first-class workshared mail is one of the, if
24 not the, most profitable products the Postal Service has?

25 A Well, you need to be a little bit careful in

1 referring to first-class mail as a profitable product.
2 Generally, the pricing criteria and cost coverages are
3 discussed at the subclass level, which, in this case, is the
4 first-class mail letters and sealed parcels. The cost
5 coverages presented for presorted first-class mail in my
6 exhibits are the highest of any rate category. However, I
7 can't confirm that there would not be some other segment of
8 some rate category that would not have higher cost coverage.

9 Q Okay. Well, I was just trying to look at it on
10 sort of an overall basis, and I guess we could reduce it to
11 the notion, and you'll help me with my math here, that you
12 have a product where for every penny of costs, you get back
13 three cents. Is that fair? Is that, in essence, what the
14 cost coverage is saying?

15 A Yes. The cost coverage is the revenue from a
16 category of mail, implicit cost coverage in this case,
17 divided by the cost for providing that mail. I think that's
18 probably a reasonable characterization.

19 MR. HALL: Thank you very much. Nothing further.

20 CHAIRMAN OMAS: Thank you, Mr. Hall.

21 Mr. Olson? For a brief moment, I thought you
22 weren't here, Mr. Olson.

23 MR. TIDWELL: Mr. Chairman?

24 CHAIRMAN OMAS: Yes. Can you speak up a little
5 bit, please?

1 MR. TIDWELL: I'm sorry. Before we proceed, the
2 Postal Service wants to clarify its understanding of the
3 cross-examination exhibit that's just gone in the record,
4 and we want to confirm that it's going to go in with the
5 corrections read into the record by the witness.

6 CHAIRMAN OMAS: Is that correct, Mr. Hall?

7 MR. HALL: That's certainly correct. If it would
8 be helpful to the Postal Service or helpful to the
9 Commission, we would be glad to submit a new copy --

10 CHAIRMAN OMAS: A new copy. Why don't we do that
11 and mark it as Exhibit MMA-1?

12 (The document referred to was
13 marked for identification as
14 Exhibit MMA-1.)

15 CHAIRMAN OMAS: Thank you, Mr. Olson.

16 MR. OLSON: Okay. I think we're ready now. Thank
17 you, Mr. Chairman.

18 CROSS-EXAMINATION

19 BY MR. OLSON:

20 Q Ms. Robinson, Bill Olson representing Val-Pak
21 Direct Marketing Systems and Val-Pak Dealers Association.
22 How are you?

23 A Good morning.

24 Q I would like to start with your response to Val-
25 Pak T-27-3, subsection H, particularly. Do you have that?

1 A Yes, I do.

2 Q Okay. We said, "If the Commission apportions all
3 other institutional costs of the Postal Service on a fair
4 and equitable basis, and you see a need to apportion the
5 escrow costs on a fair and equitable basis, not excluding
6 other factors in 3622(b), please explain whether you see
7 some fundamental difference between the two poles of costs?'
8 Do you see that question?

9 A Yes, I do.

10 Q All right. And in response to H, you say, "I'm
11 not sure what question you were asking, a fundamental
12 difference between the escrow obligation," and, I think,
13 from yesterday we now know what the escrow obligation is,
14 with Mr. Potter and Mr. Tayman's testimony, "between the
15 escrow obligation and other institutional costs is that the
16 escrow obligation is a legislative construct, and the other
17 institutional costs usually reviewed by the Commission are
18 actually incurred as a result of the operation and
19 administration of the Postal Service." Do you see that?

20 A Yes, I do.

21 Q I want to focus first on the term you used,
22 "legislative construct," and ask you a couple of questions.
23 If Congress were to enact a law that required the Postal
24 Service to use certain carriers on international flights,
5 for example, and the costs are higher because of that

1 requirement, would you view those costs as a legislative
2 construct?

3 A If those costs were imposed upon the Postal
4 Service by a congressional decision, a statute enacted by
5 Congress, they could be considered to be a legislative
6 construct. However, the difference between those and the
7 escrow obligation is that the escrow obligation has no
8 relationship to the ongoing operations of the Postal
9 Service, and the airline costs that you're discussing are
10 associated with provision of mail services, presumably in
11 some way international mail perhaps, it would depend upon
12 how those costs were specifically defined. However, those
13 are fundamentally different from the escrow obligation,
14 which is not associated with provision of postal services or
15 the operation of the Postal Service.

16 Q Well, let's say the air carrier costs the Postal
17 Service could negotiate were \$10 million, and there was an
18 extra \$10 million imposed by legislative construct. Would
19 you not agree that \$10 million is being imposed by the
20 legislation, not by the needs of the Postal Service, because
21 they could have gotten it for just the first \$10 million?

22 A If Congress mandates the Postal Service would pay
23 a specific portion for air contracts, those are costs
24 associated with those air contracts, as I would understand
5 them, and differ from the legislative imposition of the

1 escrow which are not associated with particular actions that
2 are related to the ongoing operation of the Postal Service.

3 As I understand the escrow obligation, as, I
4 believe, Mr. Tayman explained yesterday, the escrow
5 obligation requires the Postal Service to set aside \$3.1
6 billion in a test year that cannot be used for any postal
7 purpose. The types of costs you're referring to would be
8 associated, in some sense, with the operations of the Postal
9 Service, and that's a fundamental difference.

10 Q Okay. Let's think about the requirement that the
11 Postal Service could be required to pay for the costs
12 associated with military service time of their retirees.
13 First of all, is that a legislative construct?

14 A I would think that if Congress has passed
15 legislation associated with retirement costs of the Postal
16 Service, yes, you could call that a legislative construct.
17 But, however, once again, the difference is those costs, as
18 defined by Congress, are associated with the ongoing
19 operation of the Postal Service and its hiring of employees.

20 Q Just to clarify, they are actually associated with
21 the time that the employee spent working for the Department
22 of Defense, are they not?

23 A I'm clearly not an expert on the military
24 retirement costs, but to the extent that the Postal Service
25 is required to bear those costs associated with the fact

1 that employee worked for the Postal Service, they would be
2 associated in some sense with the operations of the Postal
3 Service.

4 Q Pretty tenuous, wouldn't you agree?

5 A It may be more tenuous than some other costs that
6 are more directly associated with, say, mail processing or
7 transportation.

8 Q And with respect to the escrow account, do you
9 have your own opinion as to the likely purposes for which
10 the Congress will allow the money to be expended in the
11 future?

12 A As of right now, Congress has not made any
13 designation of how those funds will be used by the Postal
14 Service. We're required to put them into escrow, and as I
15 understand it, as, I believe, Mr. Tayman explained, those
16 costs are not accessible by the Postal Service or by any
17 other party, for that matter.

18 Q So you do have an opinion yourself. What I asked
19 you is whether you had an opinion yourself as to what
20 Congress would allow those funds to be expended on
21 eventually.

22 A Eventually? No, I don't know. As I understand,
23 in the test year, those funds are required to be put into
24 escrow, and they are not available for the Postal Service
25 or, I believe, anyone else to spend.

1 Q Are you aware of any legislative history
2 evidencing that the purpose for the escrow is associated
3 with the unfunded health care liabilities of postal
4 retirees?

5 A I'm certainly not an expert on the various
6 provisions of the ongoing discussions involved with the
7 postal assignment of those costs. However, generally I'm
8 aware that there has been some discussion of assigning those
9 costs to unfunded retirement liabilities, but those actions
10 have not been taken. It's a pending legislation; it's not
11 been acted upon by Congress.

12 Q Okay. And if it were acted on by Congress, at the
13 moment that Congress were to act and say those funds needed
14 to be paid over to prefund retiree health care costs, at
15 that point, you would say they were associated with Postal
16 Service operation and administration.

17 A You would need to look at the full context of what
18 Congress had chosen to do, but to the extent that they would
19 be assigned to a specific purpose, that would be different
20 from how we face the escrow obligation right now.

21 Q So is your answer you have to look at it at the
22 time?

23 A Yes.

24 Q Okay. Would you agree with me that a certain
25 level of retirement health costs were in the Postal

1 Service's cost base in the last rate case R2001-1?

2 A As I said, I'm not an expert on the costing
3 system, but I generally understand that all of the costs of
4 labor, including retirement costs, are included in the rate
5 base when a rate proposal is presented to the Commission,
6 and I would assume retirement costs were included in the
7 proposal in the last docket.

8 Q And that would include the CSRS payments, even if
9 they were overpayments, to the best of your knowledge.

10 A I believe it would include the CSRS payments that
11 we were obligated to pay at that point in time.

12 Q Would you agree that if other Postal Service costs
13 were about \$3 billion lower in the test year, and there was
14 no projected deficit in 2006, in Fiscal 2006, that this case
15 would not have been filed? I think your testimony speaks to
16 this.

17 A This case was filed as a result of the projected
18 \$3.1 billion deficit, approximately, associated with the
19 provision of the need to fund the escrow requirement. What
20 the Postal Service has stated and what Mr. Potter has stated
21 was if the escrow obligation did not exist, the Postal
22 Service would not have otherwise filed this case.

23 Q Could I ask you to try to carefully listen to the
24 question --

25 A Okay.

1 Q -- and work with me here so I can get through in a
2 reasonable amount of time?

3 Let me go back to the question because the
4 question said, would you agree with me that if other Postal
5 Service costs were \$3 billion in the test year, and there
6 was no deficit anticipated in the test year, that there
7 would have been no case filed by the Postal Service? That's
8 the question.

9 MR. TIDWELL: Then the Postal Service is going to
10 object to the question being directed to this witness
11 because it goes to what the revenue requirement would be in
12 this case under the circumstances, and we had the revenue
13 requirement witness here yesterday.

14 MR. OLSON: Mr. Chairman, if you would just give
15 me a second, I'll find the section that it's directly
16 relevant to in this witness's testimony. It's on page 7,
17 and this witness talks about the \$3.1 billion escrow burden
18 being not unlike a tax and then says, "If the escrow
19 requirement were larger, the Postal Service would have been
20 obligated to request a larger increase in rates and fees to
21 generate the larger escrow requirement. Conversely, if the
22 escrow requirement were smaller, the Postal Service would
23 request a smaller increase." This witness testified about
24 basically the same question I'm asking. I'm trying to
25 clarify, if there were another \$3 billion offset, whether

1 there would have been a rate case. That's what I'm tying it
2 to.

3 CHAIRMAN OMAS: I'll allow the question. Ms.
4 Robinson, would you answer?

5 THE WITNESS: In this section of my testimony, I
6 am citing Witness Potter's testimony at page 5.

7 MR. OLSON: Can I say, I'm just asking you a
8 question? I'm not going back to the testimony. That was to
9 handle the objection. I have a pending question. Let me go
10 over this one more time.

11 BY MR. OLSON:

12 Q Would you agree that if the Postal Service had in
13 its other costs, other than the escrow payment, if it had
14 found a way to save \$3 billion, and there was no deficit in
15 the test year, that this case would not have been filed?

16 A I'm not sure I can agree with that. The
17 assessment of the revenue requirement, which is the subject
18 of Witness Tayman's testimony, involves a balancing of a
19 very large number of factors. My understanding was, in the
20 absence of the escrow obligation, given the financial
21 position of the Postal Service when we filed this request,
22 the escrow obligation was the sole factor driving that
23 increase.

24 Q So you're saying, even if there was an extra \$3
25 billion cost cutting in the test year and no imbalance in

1 the test year showing a negative of \$3 billion, the case
2 might have been filed anyway.

3 A No. That's not what I'm saying. What I'm saying
4 is the full circumstances involving the finances of the
5 Postal Service are evaluated. The Postal Service will file
6 a request for a change in rates and fees when it finds it
7 will not break even in a specific test year, and there is
8 consideration of a number of other things. If finances show
9 that there would be a net income of \$3 billion, it is
10 probably unlikely that a rate case would be filed for that
11 specific test year.

12 Q You did say in your testimony -- now I'm asking
13 about the testimony -- that if the \$3 billion obligation for
14 CSRS were not there, that presumably there would have been
15 no case filed.

16 A Correct.

17 Q Okay. Now, I'm asking --

18 MR. TIDWELL: Mr. Chairman, the \$3.1 billion is
19 not a CSRS obligation.

20 MR. OLSON: Well, we can call it the CSRS savings
21 going into escrow. Should we call it that?

22 MR. TIDWELL: The escrow. It is appropriate, yes.

23 CHAIRMAN OMAS: I think it's referred to as
24 escrow.

25 MR. OLSON: I would be glad to refer to it as

1 anything distinguished counsel would want me to refer to it
2 as.

3 THE WITNESS: I think the distinction is that the
4 escrow requirement is the difference between an appropriate
5 calculation of retirement costs and the requirement that I
6 believe Witness Tayman said was substantially in error. So
7 the escrow payment is not associated with ongoing retirement
8 costs for the Postal Service.

9 BY MR. OLSON:

10 Q That's not my question; that was Mr. Tidwell's.
11 But let's call it "escrow payment." If the escrow payment
12 did not exist, is it your testimony that the case would not
13 have been filed?

14 A It's my understanding, if given the financial
15 position of the Postal Service when we proposed this rate
16 increase, that if the escrow obligation did not exist, we
17 would not have filed this case.

18 Q Okay. Thank you. Now, let me ask you the next
19 question, which is, is it your testimony, though, from a
20 moment ago that if the Postal Service had \$3 billion of cost
21 savings in a different area, that it still might have filed
22 the rate case if it had to make the \$3 billion payment into
23 the escrow?

24 A If the Postal Service had been breaking even in
25 the test year or had had a \$3 billion surplus, it's unlikely

1 that they would have proposed a rate increase.

2 Q Okay. If it's unlikely they would have proposed a
3 rate increase in the event they had \$3 billion of cost
4 savings in a test year, break even, and you're certain they
5 wouldn't have proposed a rate increase if there was no
6 escrow payment due, what's the difference between those
7 costs? What's the difference between owing \$3.1 billion to
8 the escrow and \$3.1 billion of operating costs from the
9 standpoint of rate-setting criteria, such as the fair and
10 equitable standard that you referred to in your testimony?

11 A Well, the difference is in how we're treating
12 those costs. The escrow obligation is really unique in that
13 it isn't associated with the ongoing operations of the
14 Postal Service, and when we looked at that in terms of how
15 we would propose rates and fees, we felt that given the
16 pricing criteria of the act and the other provisions of the
17 act, that it was appropriate to treat that in a way that is
18 not typical of the typical ongoing costs of the Postal
19 Service. That's what led to the 5.4 percent proposal, the
20 rate increase across-the-board proposal, and it's a matter
21 of how those costs are treated and what the appropriate way
22 to treat those costs is, given the lack of association with
23 ongoing postal operations.

24 Q Do you recall my cross-examination yesterday with
25 Witness Tayman -- I believe you were in the hearing room --

1 and asked him particularly about the OBRA imposed costs on
2 the Postal Service? Do you recall that?

3 A Yes, I do.

4 Q And the many times over history where Congress has
5 come up with creative new ways to impose burdens on the
6 Postal Service and the rate payer to fund various types of
7 expenses?

8 A Yes. I remember that conversation.

9 Q And that one of them we discussed was, I believe,
10 \$2.4 billion in 1990 under the OBRA of that year, at least
11 part of which had nothing to do with ongoing postal
12 operations, and some of these OBRA expenses have to do with
13 POD, Post Office Department, expenditures. Do you recall
14 that?

15 A I recall the conversation. I can't confirm the
16 numbers you're speaking about or the specific facts
17 surrounding the OBRA.

18 Q What correlation does Congress imposing on the
19 Postal Service an obligation of the old Post Office
20 Department have to do with the ongoing operations of the
21 Postal Service?

22 A I'm clearly not qualified to talk about the
23 accounting treatment of those sorts of obligations, whether
24 they are associated with the Postal Service or the Post
25 Office Department.

1 Q I'm not asking about accounting; I'm asking about
2 rate design because you're drawing some principles. You're
3 saying that the way you recover these expenses is different
4 if it's escrow payment of \$3.1 million as opposed to other
5 types of expense that you category, I believe, as
6 administrative and operating in that same interrogatory that
7 we've been discussing. And I'm trying to get at what the
8 difference is from a rate-design standpoint as to why those
9 escrow costs are so different that they are recovered and
10 should be recovered in a different way?

11 A The escrow costs are fundamentally different, in
12 that they have no basis in providing postal services to the
13 American people. The costs you're talking about have some
14 relationship at some point in time to the provision of
15 postal services. That's not the case with the escrow
16 obligation. The escrow obligation exists because Congress
17 says it exists. It's not something that can be used for
18 postal operations. It's not defined in the same sense as
19 many of those other costs that you're referring to.

20 Q Okay. So it would be your position, then, that
21 the OBRA expenses imposed on the Postal Service by Congress
22 to pay for expenses in the Post Office Department are
23 related to the provision of postal services.

24 A They are related to the provision of postal
25 services at some point in time. The appropriateness of the

1 imposition of those costs at that point in time, I really
2 can't discuss.

3 Q Would you take a look at your response to T-27-4?
4 The thrust of this question had to do with adjusting rates
5 into the future, and I want to give you a hypothetical which
6 is fairly simple to think about and react to for me, if you
7 could, if you can just jot down a couple of numbers.

8 Let's suppose we have two products, A and B, and
9 the current rates are 20 cents for Product A and 50 cents
10 for Product B. So that's your initial starting point. And
11 then assume that the Commission recommends an across-the-
12 board increase of 20 percent on those costs in a given
13 docket, not unlike this docket. I'm using different numbers
14 to make the math easy. And so the rates for Product A go to
15 24 cents, and the rates for Product B go to 60 cents. Does
16 that math work for you, a 20-percent increase on both?

17 A That looks correct.

18 Q Okay. So the rates are 24 and 60 cents, and those
19 become the base rates for the next case, the next docket.
20 And then the next case, if the Commission were to look at
21 the situation and the relative cost levels and consider all
22 of the policies of the act and the testimony of the Postal
23 Service, and it decides the best rates for those two
24 products would be 32 cents for Product A, which is up 8
25 cents from the 24 cents -- do you see that? --

1 A Uh-huh.

2 Q -- and if it were to decide that the best price
3 for Product B would be 63 cents, up 3 cents from 60 cents,
4 that's the scenario I'm asking you to assume there -- okay?

5 A Just to be sure I'm clear, --

6 Q Sure.

7 A -- current rate for Product A is 20 cents. At the
8 first docket, the rate increases to 24 cents, and in the
9 second docket, it increases to 32 cents.

10 Q No. It doesn't increase. It's that the
11 Commission wants to --

12 A That is the Commission's recommendation.

13 Q No. It's that the Commission is of the view that
14 the costs and the evidence and the rate design and all leads
15 them that those are the proper rates. It has in mind that
16 they are the proper rates. This is the very essence of my
17 question is the considerations that the Commission will have
18 to entertain in a subsequent docket if we go with an across-
19 the-board approach. If the Commission were to recommend the
20 rates that I just said that it wants to recommend, then it
21 would be a 33.3 percent increase in the first product, A.
22 Correct?

23 A From what point, from the 24 cents to the 32
24 cents?

25 Q Yes.

1 A Yes.

2 Q Eight divided by 24, okay. But for Product B,
3 it's only a 5 percent increase. Correct?

4 A Yes. Sixty cents to 63 cents is 5 percent.

5 Q Now, do you think it's likely that in that
6 scenario the Commission could become concerned that 33
7 percent is a large increase relative to an increase of 5
8 percent for mailers of Product B and that the rate effect of
9 that one increase will be quite large on the mailers. Do
10 you think that's a reasonable reaction the Commission might
11 have in a subsequent docket?

12 A You're proposing a situation that I find very hard
13 to understand. What you're saying is the Commission
14 considers the proper rates to be a specific number, and
15 then, for some reason, they have now evaluated that
16 consideration. I would believe that if the Commission has
17 determined that the proper correct rates to recommend are a
18 certain level, that they would have taken into
19 consideration, for example, the effect on mailers of the
20 changes in rates.

21 Q Well, I'm suggesting that it is at that point that
22 they begin to look at the noncost criteria of the act
23 dealing with the impact on mailers, and they begin to look
24 at rate shock, and they begin to look at whether, you know,
25 some witness comes forward and says, "You can't do that."

1 That's going to be detrimental to those mailers. It's
2 unfair." You can't see that being raised by litigants in a
3 case or by the Commission?

4 A I think you're imposing an order on the
5 consideration of the criteria that, while I can't speak for
6 how the Commission makes its decision, is not how the Postal
7 Service approaches rate design.

8 Q Let me ask you to assume that's the way it's done
9 and that after you come up with a target rate, then the
10 Commission looks at it as entertaining thoughts about rate
11 shock and impact on the mailer. Is that so hard to believe
12 that they would think about what the costs and the coverage
13 and the rate design would be, and then they look at it, and
14 they say, "Well, that's a 33.3 percent increase. That's a
15 very hefty increase. Maybe we'll have to temper that."
16 That's inconceivable to you?

17 A It's not inconceivable that the Commission would
18 consider the effect on mailers of an increase of a specific
19 size. However, I don't believe that it's a circumstance
20 where a computation is done, a proper rate, or whatever you
21 want to call it, is calculated, and then those
22 considerations are taken into effect.

23 Q Okay. Can I ask you to assume it?

24 A All right.

25 Q A hypothetical. Okay. Now, when the Commission

1 looks at that 33.3 percent increase of Product A, and it
2 tries to see what's causing that, it might see that relative
3 costs have changed, looking at the costing testimony, and it
4 would look to see that those costs have changed over a span
5 of years, and that span of years was from a period before
6 the interim across-the-board case to the next docket, that
7 costs have been changing, but that across-the-board increase
8 covered up, papered over, all of the costing changes because
9 the across-the-board increase was not predicated on rates
10 that directly correlate with costs. Correct?

11 A No. I don't think that is correct.

12 Q Directly correlate with costs or indirectly.

13 A An across-the-board increase, as we've proposed
14 it, has not ignored the consideration of changes in costs.
15 What has been made is a determination that absent the need
16 to fund the escrow requirement, the Postal Service would not
17 be proposing a rate increase. This is a rate proposal to
18 recover a specifically identified cost that is not
19 associated with the provision of postal services. It's not
20 an ignoring of changes in costs; it is a very narrowly
21 targeted request.

22 Q Aside from the postal products where the revenues
23 would not generate adequate funds to cover costs for two or
24 three products, are you saying that the Postal Service's
25 filing in this case correlates the rates in the test year to

1 the costs in the test year? I thought it was across the
2 board.

3 A The rate change is proposed across the board.
4 There is some correlation in the rates and the actual
5 underlying costs, in that the costs associated with the
6 provision of services are incorporated in the current costs.
7 The prior docket --

8 Q In other words, they were incorporated in the
9 prior docket, in R2001-1, for example.

10 A Yes. That was a more typical closer association
11 of costs with the rates, yes.

12 Q Do you recall if Docket No. R2001-1 was litigated
13 to its conclusion was a normal case where the Commission
14 decides all of the issues or whether it was settled?

15 A I want to be very careful about characterizing
16 that because I'm not an attorney. My understanding is that
17 there was a settlement, an agreement in which most of the
18 parties agreed to a specific set of rates. I'm not sure if
19 the Commission's procedure would be viewed as litigating it
20 to its conclusion in the sense that you're talking about.

21 Q When was the last docket that was litigated to its
22 normal conclusion where the Commission establishes all of
23 the rates apart from the settlement?

24 A Now, once again, I don't want to characterize
25 Docket No. R2001-1 as not being litigated. I'm not an

1 attorney. I'm really not --

2 Q Your caveat is noted.

3 A -- qualified to discuss that.

4 Docket No. R2001-1 was unusual, in that there was
5 a settlement agreement in that case. There had been
6 settlement proposals, at least in prior cases. The last
7 case in which there was not a settlement proposal under
8 discussion was Docket No. R2000-1.

9 Q R2000-1 was the last fully litigated case with
10 that caveat.

11 A The last -- rate case, yes.

12 Q Thank you. Now, going back to Product A and
13 Product B, if the Commission had not simply changed the
14 prices across the board -- remember, we used the 20 percent
15 number? -- if they hadn't given an across-the-board
16 increase, irrespective of changes in unit costs of Product A
17 and Product B, isn't it true that when they got to the next
18 case that they wouldn't have had as much rate shock, or you
19 wouldn't have had the 33.3 percent increase for Product A?

20 A In other words, if we did not have the 20 percent
21 increase in the first docket?

22 Q Yes. In other words, if it was not an across-the-
23 board increase, but the rates which the Commission came up
24 with were tied to cost changes, and we're postulating that
25 the cost changes over this entire period before and after

1 the across-the-board increase were shifting costs to Product
2 A, they were rising disproportionately high, isn't it true
3 that if we hadn't had the across-the-board increase that
4 when you finally get around to looking at costs and
5 correlating rates with costs that the changes don't have to
6 be as dramatic with as much negative impact on mailers?

7 A I believe they are larger. If you go from 20
8 cents and have an 8 cent increase, I think it's a larger
9 percentage increase without the across-the-board. If your
10 baseline is 20 cents, you don't have an across-the-board
11 increase --

12 Q It is larger. I agree with you. The 33 is larger
13 than it would have been if you hadn't have had the across-
14 the-board.

15 A No. The percentage change from 20 cents plus 8
16 cents to 28 cents is larger than the 33 percent that you
17 have from the across-the-board increase to 32 cents.

18 Q I'm not sure --

19 A I'm not sure I'm following your question.

20 Q What I'm trying to get at here is if you, in every
21 case that comes before this Commission, if you make an
22 effort to correlate rates to costs in the test year, the way
23 that we used to do things before we stopped litigating
24 cases, doesn't that indicate that you would have more cost-
25 based rates coming out of this docket, and in the future you

1 would not have the problem of having seemingly
2 disproportionate rate changes to reflect the underlying
3 costs?

4 A Well, I think where I disagree with your assertion
5 is the characterization of postal rates as being cost based
6 in a way that you're suggesting they are purely cost based.
7 The nine pricing criteria of the act include the
8 consideration of a large number of factors that are not
9 necessarily strictly tied to costs. For example, ECSI
10 value, which has some social policy implications, is
11 considered in the setting of specific categories of mails
12 such as periodicals. Rates don't track costs specifically.
13 Costs are a component in the construction of rates, but the
14 other criteria of the act dictate how postal rates will be
15 set.

16 Q Okay. Let me put in a ceteris paribus that deals
17 with that and just say that the markups stay consistent. So
18 all we're doing is saying that the underlying costs have
19 changed; the markups stay the same. Isn't it true that if
20 you have in this scenario an interim across-the-board
21 increase, that in the future you're much more likely to be
22 required to impose rate shock on mailers to get cost-based
23 rates? Will you concede that?

24 A Your ceteris paribus says there is one pricing
25 criteria, B3. That's not the circumstance we're facing.

1 Q No. That's not my ceteris paribus. My ceteris
2 paribus is there are nine pricing criteria, eight noncost,
3 one cost, and the eight noncost stay the same. I'm asking
4 you to postulate, to assume, that all of the other criteria
5 in the act stay the same. The coverage stays the same. The
6 markup indices stay the same. Everything stays the same,
7 rate design. When you have changes in underlying costs,
8 that gets then revealed in the rates, does it not?

9 A What you're saying is that changes in the
10 underlying costs can't occur with all of the other criteria
11 evaluations staying the same. For example, if costs change,
12 and to some extent, you wish to reflect that in costs, you
13 have to consider the effect on Postal Service customers and
14 competitors. It's not an independent judgment that can be
15 made ceteris paribus.

16 Q So you won't accept my premise.

17 A No, no.

18 Q You would answer the question based on fixed
19 markups.

20 A I think the premise is fundamentally flawed in how
21 the costing criteria and the other criteria of the act
22 interact.

23 Q Then I won't pursue it.

24 Would you look at your response to T-27-5(b)? We
25 said there in the question, "Would you agree that if the

1 cost coverage of ECR is not reduced over some period of time
2 following its creation, then the creation of ECR as a
3 separate subclass will have failed to achieve 'more
4 equitable rates' and to reflect 'market characteristics'?"
5 And that's quoting Witness Moeller from his testimony in
6 MC95-1. Do you see that?

7 A Yes. However, I don't believe Witness Moeller
8 would have said that it would have failed to achieve either
9 of those things.

10 Q That's where your answer comes in. Right?

11 A Yes.

12 Q Okay. Well, that's what we're doing. Do you see
13 the question?

14 A Yes. I do see the question.

15 Q Okay. On the answer, you say no. That's the
16 first answer. Correct?

17 A Yes.

18 Q And then you go on to seek to explain that, and
19 you have three sentences. The first sentence says: "The
20 enhanced carrier route subclass provides options for
21 customers mailing geographically targeted advertising that
22 are not available to the standard regular subclass." Do you
23 see that?

24 A Yes, I do.

25 Q Okay. I guess that's true by definition because

1 ECR is now a separate subclass, but what did you have in
2 mind? What options do mailers have to use the ECR subclass
3 that were not available with former third class?

4 A My comparison here is between the ECR subclass as
5 it exists today and the standard regular subclass as it
6 exists today. There were options for some of the types of
7 mail services that are available in the current ECR subclass
8 under the old preferred class structure.

9 Q So when we asked you about whether the current ECR
10 is achieving more equitable rates compared to a situation
11 where regular and ECR were fused, you answered the question
12 with respect to today's ECR and today's regular.

13 A That was the intent of that sentence, yes.

14 Q So what options do you identify there? What
15 options do ECR mailers have that are not available for
16 standard regular mailers?

17 A There are pricing structures that allow high-
18 density advertising mail to be provided as a product for
19 customers to use.

20 Q So you're basically saying they have different
21 rates.

22 A Yes, ECR does have different rates than standard
23 mail, regular.

24 Q Okay. And then the second question was by
25 creating -- or your second response, I'm sorry, was by

1 creating a separate ECR subclass, market and demand
2 differences were recognized not only in the rate structure
3 but also to a greater extent in the classification
4 structure. What changes were there in the classification
5 structure that you're referring to? Could you list those?

6 A The establishment of ECR as a subclass allows the
7 application of the pricing criteria to the ECR products as a
8 group and separate from the standard regular mail subclass.
9 What that's allowed is a recognition of the characteristics
10 of ECR and, as you've noted, the cost coverage of ECR in the
11 construction of the rates for that class.

12 Generally, ECR has received lower rate increases
13 or the Postal Service has proposed lower rate increases for
14 ECR, and in general on an inflation-adjusted basis, many of
15 the ECR rates have actually declined since reclassification.
16 That ability to treat ECR separately from standard mail has
17 provided more discretion in making those adjustments.

18 Q So you're saying one of the reasons that ECR
19 has been a success is that it has such a low markup?

20 A No, I'm not. I'm saying the rate changes have
21 been typically proposed to be lower than for other classes
22 of mail, and in addition, the specific rates in and of
23 themselves have not increased as rapidly as they might
24 otherwise have.

25 Q And you know what they would have been apart

1 from -- how do you know what they would have been apart from
2 the creation of ECR?

3 A You can't tell what they would have been.
4 However, if you do look at some rate comparisons in a
5 circumstance where rates for many subclasses of mail
6 are -- are increasing, barely settling, ECR's rate increases
7 have been moderated since reclassification.

8 Q And what do you think about -- how would you
9 describe their coverage over the period since
10 reclassification and the changes in coverage?

11 A The coverage for ECR is relatively high compared
12 to the coverages of other classes of mail, but once again,
13 customers don't pay house coverages; they pay rates, and
14 there has been an attempt to moderate the changes in those
15 rates since reclassification.

16 Q Have -- what moderation has occurred in the -- in
17 the ECR coverage in -- in 90 -- or 97-1 and 2000-1 and 2001-
18 1 or in this case?

19 A In the prior dockets, it's my understanding that
20 the rate proposals considered the effect on the ECR mailers
21 of potential rate changes, and generally the Postal Service
22 rate policy witness in those cases expressed concern that
23 while the cost coverage for ECR was relatively high compared
24 to the cost coverages for other classifications of mail,
25 that was one reason that that witness would have proposed a

1 lower than otherwise rate change.

2 Q As a matter of fact, in our question to you there
3 at T-27-5, we recite some of that earlier testimony, and
4 frequently the indication is that, just as you said, that
5 they wish the ECR could have had a lower coverage, but
6 sometimes it couldn't because others would have had to pay
7 more, isn't that correct?

8 A That's one factor is it's a balancing of the cost
9 coverages across the various classes of mail, and you -- you
10 have to consider the totality of the rate proposal in -- in
11 proposing coverages for ECR or for any other subclass of
12 mail.

13 Q And you say that in your last answer, your last
14 sentence there of your answer to B, that having subclass
15 status provides opportunities to reevaluate coverage. Are
16 you indicating that there's something in the works for the
17 future for ECR coverage where their coverage would be
18 reevaluated and perhaps lowered?

19 A The cost coverage for every subclass is
20 reevaluated when the Postal Service files a request for a
21 change in rates.

22 Q How about lowered?

23 A I -- I really can't speculate on whether cost
24 coverages would increase or decrease specifically in
25 a -- in a future docket. There are a lot of factors in the

1 Postal Service's operations and costs, for example, the
2 expanding network and the expanding institutional costs and
3 the fact that first class mail is declining that make it
4 very difficult to speculate as to whether cost coverages for
5 ECR or any other class would go up or would go down.

6 Q Okay. How about with re -- changes in ECR cost
7 coverage relative to standard regular? Any opinion there?

8 A I think the same caveats have to apply.

9 Q Okay. Take a look at your response, please, to T-
10 27-7. I'm sorry, I think we -- we should go to
11 T-17-D.

12 A T?

13 Q T-28, 17-D, which was --

14 A Valpak?

15 Q It was a Valpak. It was asked of Witness Taufique
16 and redirected to you. Do you recall that?

17 A Yes, I do.

18 Q In that response to D -- oh, here it is. The
19 first sentence of the response says, "In this
20 example" -- I'm going to ask you what a -- what a word means
21 --

22 A Mm-hmm.

23 Q -- as I don't think we have to go through the
24 whole question. "In this example, it is unclear whether you
25 were referring to marginal costs or total costs." And my

1 economist friends tell me that there is no such thing as the
2 "total cost" of producing a product. Could you tell me what
3 you meant by the term "total costs"?

4 A I'm sorry, your comment was?

5 Q That the term "total costs" is not ordinarily
6 used. I'm just wondering what you mean by "total costs."

7 A In my experience, that cost -- the term "total
8 costs" is typically used by economists to describe the total
9 cost of providing a product, the volume of variable cost
10 plus the fixed cost associated with providing that product.

11 Q So that's your -- your definition of what you mean
12 there as opposed to marginal costs.

13 A Marginal cost is the cost of producing one more
14 unit. Total cost would be the cost of producing a number of
15 units.

16 Q So you mean -- are you speaking of average costs
17 basically? Is that what that means?

18 A You can refer to average total cost as being the
19 total volume --

20 Q Or unit cost?

21 A You can talk about unit total cost, average total
22 cost, as being the -- for a fixed number of --
23 of -- of units of a product the variable cost plus the total
24 cost divided by the quantity of units produced.

25 Q So you would say that any time someone uses the

1 term "unit cost," it means unit total costs; any time that
2 someone uses the word "average costs," it means average
3 total costs.

4 A No, I would not necessarily say that.

5 Q I must have misunderstood you.

6 A I think my distinction is between marginal costs
7 or the cost of producing one more unit and average total
8 costs or the total cost of producing a number of units
9 divided by the number of units.

10 Q So we could just take the word "average" or "unit"
11 and substitute that for "total" and that would be okay with
12 you in terms of the meaning you intended?

13 A I would prefer to use the term "average total
14 costs" in that context.

15 Q Okay. Average total costs.

16 A I believe.

17 Q Your testimony sets out Witness Thress'
18 elasticities on page 16, correct?

19 A Yes.

20 Q And there you have the elasticity set out for
21 standard regular and standard ECR, and I wonder if you could
22 --

23 A Excuse me. It's page 15.

24 Q And right you are. That's it. On page 15, can
25 you tell me what the elasticity is for standard regular?

1 A -0.267.

2 Q And the elasticity for enhanced carrier route?

3 A -1.093.

4 Q And would you agree that when you compare those
5 two numbers that the elasticity for standard ECR is -- is
6 more than four times the elasticity of standard regular?

7 A I would agree an absolute value it's approximately
8 four times. I haven't done the math.

9 Q Okay. Would you agree that standard regular has
10 one of the least elastic demands of any product in the
11 chart? On the bottom --

12 A Mm-hmm.

13 Q -- quarter anyway, correct?

14 A All products with a lower elasticity than standard
15 regular include the periodicals products, in county, non-
16 profit, and classroom regular periodicals. Also includes
17 single piece first class mail, letters and sealed parcels.

18 Q So would it be in the bottom group then?

19 A It -- oh, gee.

20 Q Well, let's move --

21 A It --

22 Q -- let me ask the more easy -- the easier
23 question. Just take a look at the -- at the elasticity
24 for -- for ECR. Would you say that that's one of the
25 highest of any product in your chart? Express mail is

1 higher, do you see that?

2 A It is the third highest.

3 Q Okay.

4 A Parcel select is higher.

5 Q Thank you.

6 A Express mail is higher.

7 Q Okay. And it's higher even than the highly
8 competitive priority mail, correct?

9 A Yes. 1.093 is greater than 1.044 -- oh, 004,
10 excuse me.

11 Q What significance does it have to your testimony
12 that the elasticity for ECR is four -- four times, as you
13 say, approximately four times the elasticity of standard
14 regular?

15 A In postal rate-making, the measures of elasticity
16 are typically used as one measure of the economic -- of the
17 value of service, specifically the economic value of service
18 that's generally used in the application of the pricing
19 criteria. However, in this case, we really are faced with
20 unusual circumstances.

21 Q Unique.

22 A Unique. The consideration of the value of service
23 of standard ECR and of all the other classes of mail was
24 looked at in the context of what the escrow obligation was.
25 The value of service is incorporated in the current rates

1 through the Commission's cumulative recommendations of those
2 rates, so it is in the rate structure that we're applying
3 the across-the-board rate increase to. The escrow --

4 Q So it's in the rates from R-2000-1 or R-2001-1,
5 whichever you --

6 A It is in the rates from R-2001-1, excuse me. And
7 the escrow obligation in and of itself is not driven by the
8 value of service for specific custom -- for specific classes
9 of mail. The fact that one class of mail has a higher value
10 of service than another class of mail has no relationship to
11 how or why the Postal Service is obligated to pay these
12 costs.

13 Q No, I'm --

14 A The escrow obligation is completely
15 unrelated --

16 Q No --

17 A -- to value of service as measured by elasticity
18 or measured on the basis of other intrinsic characteristics.

19 Q So, in other words, they had no bearing on the
20 rates that you're recommend -- the coverages you're
21 recommending in this docket?

22 A No, that's not the case. The coverages
23 recommended in this docket incorporate the -- the current
24 rate structure which includes the assessment of value of
25 service over the period since reorganization by the

1 Commission.

2 Q Okay. Let me ask you this. Do they include
3 changes in coverage since Docket R-2001-1?

4 A In the consideration of whether to propose an
5 across-the-board increase, one of the factors that was
6 discussed was whether that -- that approach was
7 inappropriate given any changes in things such as value of
8 service or any of a number of other things that could be
9 considered.

10 The determination was made that the changes in
11 elasticity or value of service were such that the importance
12 getting the income through an across-the-board approach
13 was -- was it was an appropriate weighting of those
14 criteria. The value of service as indicated by the current
15 rates has not substantially changed, and there was nothing -
16 - no change there that suggested that that factor, that
17 consideration, outweighed the fairness and equity of using
18 an across--the-board approach to recover the escrow
19 obligation.

20 Q So your testimony is that you looked at all the
21 changes in elasticity from R-2001-1 to R-2005-1 and then --
22 and then, in the aggregate, said it's okay, we still -- it's
23 unique and we need to go with across-the-board?

24 A What occurred was a consideration of the
25 elasticities and changes in other measures of value of

1 service which are not strictly associated with elasticity.

2 Q How did elasticity change for standard regular
3 between those two cases, between R-2001-1 and R-2005-1?

4 A I don't have the R-2001-1 numbers in front of me.

5 Q If I were to suggest that -- that I looked it up
6 and it was -0.388 and now it was -0.267, is that a
7 significant reduction in elasticity?

8 A That is a reduction in the elasticity, assuming
9 the -- the numbers that you're providing are correct.

10 Q Right.

11 MR. TIDWELL: Could -- could counsel favor us with
12 a citation?

13 MR. OLSON: I will be glad to. The citation for
14 that number is USPS T-8, page 49 from Docket No.
15 R-2001-1.

16 MR. TIDWELL: Thank you.

17 THE WITNESS: The -- the difficulty I'm having
18 with drawing the conclusion that's a significant reduction
19 has to do with what I understand Witness Thress' testimony
20 is about elasticity. I have a number of questions from
21 other parties regarding first class mail elasticities, and I
22 understand it's generally difficult to -- to necessarily
23 characterize that as a reduction in elasticity.

24 BY MR. OLSON:

25 Q Is it an increase?

1 A It is a reduction in the estimate of the
2 elasticity.

3 Q Take a look -- well, not take a look, but could
4 you assume that for standard ECR that the R-2001-1
5 elasticity was -0.770?

6 A I'm sorry?

7 Q -0.770, and the reference is USPS T-8, page 50,
8 Docket No. R-2001-1. And that increased from .770 to 1.093.
9 Is that a significant increase in the elasticity of standard
10 ECR? Or would you give me the same answer that you did for
11 regular? It may not be.

12 A To the extent that we're characterizing what
13 changes those numbers would mean, I need to defer to Witness
14 Thress on that. He's the expert and developed these
15 elasticities. It is an -- it is an increase in the estimate
16 of the elasticities.

17 Q Is it fair to say that stated another way that
18 comparing the elasticity of standard regular and standard
19 ECR that it indicates that standard regular can absorb a
20 rate increase more easily than can standard ECR without
21 losing large volume?

22 A A lower elasticity of demands such as standard
23 regular has as compared to -- to enhanced carrier at ECR
24 suggests that if you have the same percentage increase,
25 there would be less of a volume loss in standard regular

1 than there would be in -- in standard ECR. I --

2 Q Would that be a yes then on my question?

3 A I'm not quite sure what you mean by the word
4 "absorb," but there's a greater volume reaction in standard
5 ECR.

6 Q In -- for standard regular mail in test year 2006,
7 the number I have is 50 -- 56.9 billion volume, is that --
8 and ECR about 33.3 billion pieces. Does that look about
9 right relative one to the other?

10 A Yes.

11 Q And therefore, the -- the total volume of standard
12 regular is, by my math, 1.7 times as large
13 as -- as ECR, or the other way around, that ECR is 58
14 percent of standard regular, whichever way you want to look
15 at it. Does that look about right?

16 A Generally, yes.

17 Q Okay. Now the proposed rates for average rate
18 increase for standard regular is 5.3 percent, correct, in
19 your table?

20 A The proposed increase for standard regular is 5.4
21 percent.

22 Q Oh, that's right. There are two different
23 numbers. We asked an interrogatory about that. Two
24 witnesses had two numbers, as I recall. And so you're using
25 5.4, and what's the number you're using for ECR?

1 A 5.5.

2 Q Okay. Instead of 5.6, which another witness uses,
3 correct?

4 A There was a slight difference in the calculation
5 of the percentage changes. My numbers hold the volume mixed
6 constant volume and volume mixed constant so movements in
7 the volume forecast causing shifts between various rate
8 categories don't distort percentage change.

9 Q Okay. And looking at the -- so you think your
10 method is more accurate, is that what you're saying?

11 A Yes, I do.

12 Q Okay. And the other witnesses less accurate.

13 A I believe the method I'm using accurately reflects
14 the effect on customers of a change in prices.

15 Q Okay. And for standard regular, that 5.4 percent
16 increase in this docket would result -- I guess I'll -- if
17 you don't have this, I'll ask you to assume it -- a
18 reduction in volume of 507 million pieces for regular, okay?

19 A All right.

20 Q And the corresponding reduction for ECR for the
21 5.5 or 5.6 percent increase in price is 1.1 billion pieces.
22 Can you draw any conclusion from that as to how much lost
23 contribution to institutional cost the Postal Service might
24 have from those relative changes in volume?

25 A The Postal Service is not losing contribution from

1 either of these subclasses as a result of a rate increase.

2 Q No, as a result of these specific lost volumes.

3 A But these -- these volume losses are coming as the
4 result of a rate increase whose net effect is an increase in
5 contribution.

6 Q Oh, I agree the net effect is an increase in
7 contribution. I'm just trying to deal with the comparison
8 of the lost volume and the net effect on Postal Service
9 finances of that lost volume. Do you think -- can you just
10 work with me for a second? Then I'll give you a chance to
11 tell you -- tell me whether you think this is irrelevant.

12 But if -- if there -- if standard regular lost 507
13 -- by the way, let me ask you, do you have in your testimony
14 unit contribution numbers?

15 A I believe we presented them in the total basis,
16 not on a unit basis.

17 Q Okay. Because, when Mr. Hall was here before, you
18 were dealing with unit contributions. Was that something
19 you calculated yourself?

20 A That was a cross-examination exhibit provided by
21 Mr. Hall that we checked yesterday.

22 Q Okay. So unit contribution -- to your knowledge,
23 unit contribution numbers are not in the Postal Service's
24 case, are they?

25 A I can't think of a specific case where we

1 presented them. They're very easy to calculate from -- from
2 the numbers that we do have.

3 Q Okay.

4 A The data would be relatively straightforward to
5 compute.

6 Q Just for purposes of this question, I went back to
7 R-2001-1 and used the opinion and recommended decision
8 appendix G number, and I -- I took that number as an order
9 of magnitude since I didn't have -- I didn't compute it and
10 I didn't have it from the case.

11 What that shows if you had -- I'm going to suggest
12 to you and I'm going to then ask you to give me your
13 reaction to this -- that the 5.4 percent increase in regular
14 mail, standard regular, loses 507 million pieces and those
15 pieces correspond to a loss of contribution to institutional
16 cost of \$28 million. That's at 5.583 cents per piece, and I
17 know that's from the prior docket, so these numbers are --
18 would have to be adjusted for this case. But do you follow
19 what I'm saying so far?

20 A I actually don't believe that's an appropriate way
21 to characterize that. There is a volume reduction as the
22 result of a price increase, but what you're trying to do is
23 to segregate that volume reduction from the -- the -- the
24 change in contribution from the class as a whole --

25 Q That's exactly what I'm trying to do.

1 A -- and I don't think that's appropriate to do in
2 this case.

3 Q Yes, that's exactly what I'm trying to do. In a
4 minute, I ask you to explain why you don't think it's
5 appropriate, but just if you could work with me to --

6 A Mm-hmm.

7 Q -- come up with these two numbers; then I'm going
8 to ask you to compare them. So the -- the 5.4 percent
9 increase in standard regular leads to a loss of 507 million
10 pieces or a loss of \$28 million in contribution. Those are
11 the numbers we just went over, correct? You don't have to
12 accept it, but you know what I'm talking about, right?

13 A I believe the arithmetic --

14 Q Okay.

15 A -- change in volume times the change in
16 contribution will get you a number that's somewhere in that
17 range.

18 Q Good.

19 A I don't believe that's an appropriate way to look
20 at these numbers.

21 Q No, I -- I know, and you can say that after I ask
22 you this question, too, but --

23 CHAIRMAN OMAS: Mr. Olson?

24 MR. OLSON: Yes.

25 CHAIRMAN OMAS: Could you please give us an idea

1 about how much longer you have?

2 MR. OLSON: Oh, for probably 20 minutes.

3 CHAIRMAN OMAS: Well, in that case, it -- this
4 looks like a good point in time to take our midmorning
5 break. We'll come back at 10 minutes after 11.

6 (Whereupon, a brief recess was taken.)

7 CHAIRMAN OMAS: Mr. Olson, you may continue.

8 MR. OLSON: Thank you, Mr. Chairman.

9 CROSS-EXAMINATION (RESUMED)

10 BY MR. OLSON:

11 Q Ms. Robinson, I want to pick up where we left off
12 in this discussion of lost volume for standard regular and
13 standard ECR and the lost contribution that correlates to
14 that lost volume. We finished talking about standard
15 regular, I believe, where we said that the rate increase,
16 the across-the-board rate increase would lose 507 million
17 pieces, which correlates roughly using the last -- the
18 numbers from the last docket to \$28 million lost, and you
19 recall that?

20 A I recall the conversation. I would not agree that
21 they change in volume as a result of the across-the-board
22 rate increase results in a loss of contribution. The net
23 effect of the rate increase is an increase in contribution.

24 Q Right. I'm willing to stipulate that the net
25 effect of an increase in rates where ECR results in

1 an -- a net -- that the increase in rates results in a net
2 increase in contribution, but I think you realize what I'm
3 focusing on are the pieces that are lost because there is a
4 low elasticity for standard regular and a high elasticity
5 for standard ECR. I mean, you do realize where I'm going
6 with these questions, right? You just don't want to help me
7 get there?

8 A I'm not sure I understand where you're going.
9 However, the volume response in a higher elasticity subclass
10 is greater than the volume response in a lower elasticity
11 subclass in absolute value.

12 Q Okay. And on a unit contribution basis, which
13 product, standard regular or standard ECR, has a higher unit
14 contribution?

15 A I believe standard regular.

16 Q Well, in Docket No. R-2001-1, Appendix G, the
17 standard regular unit contribution was 5.583 cents, and for
18 ECR, it was 8.133 cents. Would you accept those numbers
19 subject to check?

20 A I have no reason to disagree with those numbers.
21 The markup for ECR is higher; however, that may be
22 appropriate on the contribution. I haven't checked those
23 numbers lately.

24 Q But it surprises you to learn that the unit
25 contribution is higher for standard ECR than for standard

1 regular? That's what you're saying?

2 A No, I'm not saying it surprises me. It's numbers
3 I don't have with me at the moment.

4 Q If the across-the-board increase as applied to
5 standard ECR would result in a 1.1 billion approximate
6 reduction in volume, I'm -- I'm asking you to -- you need
7 not look it up. I mean, just sort of accept that that's the
8 number. And the -- if you --

9 A I mean, the numbers you're providing appear to be
10 from Valpak USPS T-7-4 in which I stated the reduction in
11 standard mail ECR volume between the test year before rates
12 and the test year after rates is 1.141806 thousand cases.

13 Q Exactly. And that's the number I'm working with
14 here.

15 A Okay.

16 Q So that 1.1 approximately billion pieces of lost
17 standard ECR volume, if you apply an 8.133 cent per piece
18 contribution to institutional cost, you're dealing with
19 about \$93 million in lost contribution from those pieces,
20 correct?

21 A If you take the change in volume times the
22 contribution per piece, it would appear you would get the
23 number on the order of what you're discussing.

24 Q Okay. So the way that I'm presenting this to you
25 with only 58 percent -- taking a look at standard ECR with

1 only 58 percent of the volume of standard regular, the
2 Postal Service stands to lose three times the contribution
3 to institutional costs from an across-the-board rate
4 increase from standard ECR compared to standard regular,
5 would that not be correct?

6 A No, that's not --

7 Q I'm not talking -- I'm not talking about the total
8 contribution. I'm talking about the contribution from the
9 pieces that it loses under Witness Thress' elasticities in
10 an after rates context.

11 A You're trying to segregate the effect of a rate
12 change in a way that I do not think is appropriate.

13 Q Okay. But I am trying to segregate it, and you do
14 understand what I'm trying to do. Would you simply -- I'll
15 give you all the opportunity in the world to tell me why
16 it's inappropriate, but do you -- do you understand what I'm
17 saying when I say the Postal Service is losing three times
18 the contribution to institutional costs by this across-the-
19 board increase from ECR than it is from regular? It's
20 losing \$93 million as opposed to \$28 million in the test
21 year.

22 A Having not done the arithmetic, be able to confirm
23 the arithmetic, I will assume your numbers are correct. The
24 -- the calculation of the change in volume times the average
25 contribution per piece would be larger for ECR than it would

1 be for standard regular. However, I don't agree that's an
2 appropriate way to look at these numbers.

3 Q Okay. Now tell us, now tell us why it's
4 inappropriate.

5 A In presenting a proposal for an increase in rates,
6 the goal of that proposal is to increase revenue by making
7 adjustments in rates with the recognition that there will be
8 some volume reduction.

9 The net impact is not a change in contribution
10 associated with the volume that is -- that goes away or is
11 reduced as a result of the changes in rates. The net impact
12 effect on the Postal Service's bottom line is
13 the -- the -- the combination, and it's not something that's
14 easily separatable between the fact that some volume is lost
15 and the remaining pieces earn -- or contribute more
16 contribution.

17 That -- that effect is -- is intertwined in a way
18 that I don't think you can reasonably segregate it because,
19 if you take this in the other direction, by that logic, you
20 would continually increase contribution if you reduced
21 prices.

22 Q I understand that.

23 A The opposite doesn't work in the same way that
24 this doesn't work. It doesn't separate readily.

25 Q You're -- you're saying that -- well, I'm

1 not -- I'm not sure it's significant. Let me ask -- let me
2 ask you if you were to have an elasticity of -- of regular
3 mail, standard regular mail, that approached zero --

4 A Mm-hmm.

5 Q -- and an elasticity of ECR that approached say
6 1.4 or five so that you could raise rates on standard
7 regular with abandon and not lose volume, but if you -- you
8 come perilously close to losing money on ECR by a rate
9 increase, that wouldn't that be a relevant rate-setting
10 consideration for you?

11 A It is a relevant rate-setting consideration in the
12 effect that elasticity measures the economic value of
13 service, which is one of the things we would consider in the
14 value of service. I'd note that the elasticity that you --
15 you hypothetically pose is approximately that of express
16 mail where we do have a rate increase and an enter --
17 increase in contribution from that class of mail.

18 Q Do you anywhere in your testimony discuss standard
19 ECR or standard regular mail and how the non-cost criteria
20 of the Act apply to those products, specifically to those
21 products?

22 A Because of the unique circumstances in this case -
23 -

24 Q Is that a no?

25 A That is a no, with an explanation.

1 Q Okay. So the no, and then go ahead.

2 A Generally, the rate level testimony the Postal
3 Service presents goes through the pricing criteria in
4 specific reference to each of the classes of mail including
5 standard ECR. What we've done in this case is presented the
6 issue as we find it, which is that we're faced with an
7 escrow obligation that's not associated with revision of
8 postal services, and there are not significant changes in
9 the evaluation of the underlying criteria or the financial
10 position of the Postal Service that would otherwise require
11 an increase in rates.

12 Q So the conventional type of pricing witness that
13 the Postal Service puts on in the conventional type of
14 pricing testimony that the Postal Service puts on where it
15 discusses the various major products, that wasn't necessary
16 because of the unique nature of this case, correct? That's
17 your position.

18 A What I've done in my testimony is presented the
19 Postal Service's proposals for rate levels in this case and
20 an explanation of why these proposals are consistent with
21 the criteria of the Act. We do discuss the fact that there
22 have not been significant changes in the evaluation of a
23 number of the criteria to the extent they're incorporated in
24 the current rate structure.

25 We do not do a blow-by-blow through each class of

1 mail and explain for the case of standard mails, letters,
2 and sealed parcels, ECR and so on, that those changes have
3 not -- you know, we don't do the same explanation for each
4 class of mail.

5 However, we did consider the effect to which any
6 of those -- those circumstances would mitigate against a
7 proposal of across-the-board rate increase to recover the
8 escrow obligation and believe that the -- the -- the
9 underlying rate structure, the current rates, appropriately
10 reflect the consideration of those criteria, and when the
11 criteria are applied to the additional escrow burden, that
12 it is a fair and equitable and consistent with all of the
13 policies of the Act to propose a 5.4 percent across-the-
14 board increase.

15 Q Okay. Let me go back and ask my question again.

16 A Mm-hmm.

17 Q I asked, is it your testimony then that the
18 conventional type of pricing witness that the Postal Service
19 puts forward who in their testimony deals with each product
20 for which a coverage is being -- or markup is being
21 recommended, that they discuss each product as the non-cost
22 criteria apply to them? That wasn't necessary in this case
23 because of the unique nature of the revenue requirement, is
24 that correct?

25 A (Nonverbal response.)

1 Q Now you -- your -- your answer went off into all
2 the things you considered that made no difference because,
3 in the end, everything was okay, but it's not your
4 testimony, correct?

5 A I do not discuss on a subclass-by-subclass basis
6 the application of the specific nine pricing criteria.
7 However, those pricing criteria were
8 applied --

9 Q Where --

10 A -- in the -- in the construction of this proposal.

11 Q Okay. And where does the record reflect that,
12 this consideration that you discuss?

13 A There's -- there's a number of interrogatories
14 that discuss how we determined that this proposal was
15 consistent with the pricing criteria, and I believe my
16 testimony discusses that.

17 Q Well, your testimony basically says that the rates
18 in the aggregate are fair and equitable and this is the best
19 way to recover these unique expenses. Is that not the main
20 driving criterion, Criterion One?

21 A Criterion One is -- has a substantial role to play
22 in the -- in -- in any rate proposal, the ultimate result
23 must be fair and equitable. We do go through and discuss
24 the number of other criterias, all of the other criterias,
25 and explain why we believe our proposal is consistent with

1 each and every one of those criteria.

2 Q Could you turn to page 24 of your testimony?
3 These are the markup indices in the first column in Docket
4 No. R-2005-1 that you're proposing, is that correct?

5 A Yes, it is.

6 Q Okay. What is the highest markup indicia in the
7 chart? What product does it correlate to?

8 A It's the combined standard mail ECR and NECR
9 subclasses.

10 Q Okay. At 1.610?

11 A Yes.

12 Q And for comparison purposes, what is the standard
13 mail regular and non-profit markup indicia?

14 A Under the postal services proposed in this
15 docket --

16 Q Yes.

17 A -- 0.666.

18 Q Would you agree that until Docket No. MC-95-1 when
19 standard regular was separated from standard ECR that --
20 that both of these products were part of third class mail?

21 A Yes.

22 Q And they had the same coverage in each prior
23 docket?

24 A I think it's difficult to say that two parts of a
25 subclass have the same coverage, as has been pointed out in.

1 first class mail between single piece
2 and -- and presorted.

3 Q Well, there are always different implicit
4 coverages, but they --

5 A I don't think you can make the -- I'm not sure you
6 can reach that conclusion directly in that the implicit
7 coverages are not necessarily calculated prior to.

8 Q Is it true -- is it true that the Postal Service
9 requested and the Postal Rate Commission recommended rates
10 which encompassed a single explicit coverage for standard --
11 excuse me, for third class mail prior to MC-95-1?

12 A Yes, that's my understanding.

13 Q Okay. And then within it, there may have been
14 implicit coverages on a whole variety of products, correct?

15 A Yes. Presumably, those could have been calculated
16 by the submission data.

17 Q Okay. Now does the fact that the markup indicia
18 of the ECR products is 1.610 and standard regular is .666,
19 do you draw any conclusion from that about how markups have
20 changed over the years with respect to what used to be third
21 class mail?

22 A Not having the -- the history of the markup
23 indices in front of me, I generally believe those markup
24 indices have -- have increased somewhat, particularly for
25 ECR.

1 Q Okay. And in general, you could say, could you
2 not, that standard regular and non-profit are way below
3 average and standard ECR and NECR are way above average?

4 A By definition of an indicia, any number below 1
5 would be below the average markup for the mail system as a
6 whole. Any average --

7 Q But the average is 1.0, correct?

8 A Yes.

9 Q Okay. So would you agree that standard regular
10 and standard non-profit are significantly below average when
11 standard ECR and -- and NECR are significantly above
12 average?

13 A I would agree that standard regular and non-profit
14 are below average. However, I note there are a number of
15 other subclasses which have markup indices that are -- are
16 substantially below that level.

17 Q So you wouldn't call it significant. You'd say
18 it's insignificant maybe.

19 A Significant's a term that's very hard to -- to
20 quantify. I would note that they are below the average of
21 1.0. However, I'd also note that, for example, periodicals
22 in county has a markup index of 0.048, which is --

23 Q Well, I'm going to let periodicals take care of
24 themselves and just focus you back on regular and ask you
25 this. Isn't it true that there's only one markup indicia

1 for ECR and NECR, and if there were a separate number for
2 ECR, the commercial product, that it would be higher
3 necessarily than this 1.610?

4 A Because of the statutory treatment of ECR and NECR
5 the cost numbers for those are not broken out separately and
6 we cannot calculate the mark-up indices for those two
7 subclasses separately.

8 Q The ECR components one would think would have had
9 a higher mark-up index in the absence of nonprofit, wouldn't
10 you think?

11 A Having not done that calculation, I don't know.
12 In a very general sense, given the rate preferences for
13 nonprofit that's probably not an unreasonable.

14 Q Let me just ask you to discuss with me the
15 coverage you're recommending. You don't set out the
16 coverages actually in your testimony, but they're in your
17 Exhibit No. 27(b), correct?

18 A Yes. The test year after rates coverages are in
19 Exhibit No. 27(b).

20 Q What's the coverage recommended for standard,
21 regular and nonprofit?

22 A The combined standard, regular and nonprofit
23 subclasses is 159.6 percent cost coverage.

24 Q I'm sorry. Could you repeat that number?

25 A The combined standard mails, regular and nonprofit

1 subclasses have a cost coverage of 159.6 percent. It's
2 Exhibit No. USPS 27(b) revised on June 10.

3 Q What is the coverage for standard ECR and NECR?

4 A Cost coverage for the combined ECR and NECR
5 subclasses is 244.1 percent.

6 Q Would you agree with me the difference in
7 percentage points is 85.5 percent higher for ECR and NECR?

8 A Yeah. That's approximately the difference.

9 Q As the Postal Service's pricing witness are you
10 the one recommending these coverages to the Commission?

11 A Yes, I am.

12 Q What is the highest coverage of any postal
13 product?

14 A The highest recommended cost coverage for a
15 subclass would be the combined ECR/NECR subclass; however, I
16 would note that on this table we do show presort and
17 automation letters' implicit cost coverage of 331.8 percent.

18 Q Where in your testimony were the exhibits you
19 discuss how the noncost factors to the act justify an 85.5
20 percent difference in coverage between standard regular and
21 standard ECR?

22 A My testimony does not discuss the specific
23 comparison of standard mail, regular and ECR combined with
24 the associated nonprofit subclasses specifically; however,
25 the incorporation in the rates of the Commission's

1 cumulative assessment of the noncost pricing criteria of the
2 act is embedded in our discussion of why an across the board
3 increase is appropriate in this case.

4 Q However, there's no specific discussion of
5 standard regular and standard ECR for justifying the
6 specific differential between the two of 85.5 percent,
7 correct?

8 A I believe our discussion of how the pricing
9 criteria apply to this proposal does discuss that in some
10 sense. We do not discuss the specific comparison, no.

11 Q You can't turn to a place where you discuss ECR or
12 standard regular in the section of your testimony that
13 applies to the noncost factors of the act, correct?

14 A No. There's not a section specifically discussing
15 that; however --

16 Q Not a section, but any work, any sentence even
17 specifically?

18 A Specifically, no; however, those were considered
19 in our construction of this rate proposal.

20 Q I'm sure everything was considered, I was just
21 focusing on what you actually presented to the Commission
22 that's on the record. We discussed before unit
23 contributions and again I didn't do the math, so all I've
24 got is 2001-1 to deal with, and there the unit contribution
25 of ECR and NECR was 8.133, you may recall, and regular and

1 nonprofit was 5.583.

2 The difference is 2.550. Do you believe that the
3 unit contributions of various postal products is a
4 significant consideration that the pricing witness and the
5 Commission should take into account in a normal rate case?
6 Not just coverage, mark-up indices, but focusing now on unit
7 contributions, per piece contributions.

8 Do you think that's an important consideration to
9 focus on?

10 A I'd like to make one clarifying point about the
11 unit contributions which is the numbers you're citing are,
12 assuming they're accurate, from the Commission's prior
13 decision. There are costing methodology differences between
14 that and the numbers I'm presenting here.

15 Q Just for clarity.

16 A Just for clarity.

17 Q I appreciate that because I'm sure the numbers are
18 different now. I don't know what they are because I haven't
19 done the math and I'm sure we will in brief for something,
20 but at the moment if there were something like this, a 2.55
21 cent unit contribution difference between standard ECR and
22 standard regular what relevance does that have?

23 Is that a significant consideration or is that
24 really not where the focus ought to be, we ought to be
25 looking at mark-up and coverage?

1 A You need to look at the totality of the
2 circumstances surrounding any specific rate proposal. That
3 includes an examination of the mark-ups, relative mark-ups,
4 rate relationships and a variety of other considerations
5 that are not directly associated with cost and cost
6 coverages.

7 For example, the impact of a rate change on
8 customers. Customers don't pay cost coverage if they don't
9 pay mark-up, they pay rates. You need to look at the
10 combined total of that entire picture in order to make a
11 determination as to what an appropriate rate proposal is.

12 Q Are you saying then that total look at everything
13 includes looking at unit contributions?

14 A I think that's certainly something you could look
15 at; however, you can't look at it isolation.

16 Q Do you think it is desirable to have standard ECR
17 and standard regular have that difference in unit
18 contributions? Do you have an opinion on that?

19 A Yes. My testimony is that those are appropriate
20 cost coverages given the pricing criteria of the act.

21 Q Well, those aren't cost coverages at all, are
22 they? They're unit contributions.

23 A They are implicit in the cost coverages. The
24 contribution is not independent of a cost coverage.

25 Q No, but it reflects cost also.

1 A So does the cost coverage.

2 Q Well, cost coverage doesn't reflect cost does it?
3 Isn't cost coverage applied to cost?

4 A A cost coverage as calculated reflects the level
5 of cost at a specific point in time.

6 MR. OLSON: I think I'll end at that point. Thank
7 you, Ms. Robinson.

8 Thank you, Mr. Chairman.

9 CHAIRMAN OMAS: Thank you, Mr. Olson.

10 Is there anyone else who wishes to cross-examine
11 witness Robinson?

12 Mr. Tidwell?

13 MR. TIDWELL: The Postal Service would ask for
14 about two minutes with its witness.

15 CHAIRMAN OMAS: Fine. We'll just all sit and
16 wait.

17 Mr. Tidwell?

18 MR. TIDWELL: Mr. Chairman, I'm watching the rest
19 of my two minutes tick by. We have no redirect.

20 CHAIRMAN OMAS: Very good. Well, at this point
21 it's so close to lunch I think what we'll do is we'll take a
22 lunch break now before we start with witness Taufique. Why
23 don't we all come back say around 1:00. Why don't we make
24 it 1:15.

25 Mr. Hall? Yes, sir?

1 (The document referred to was
2 marked for identification as
3 Exhibit No. XEMMA-1
4 (revised).)

5 MR. HALL: We've made the changes necessary on the
6 Exhibit No. XEMMA-1 and I'm going to have two copies to the
7 reporter with the assistance of my able co-counsel here.

8 The other thing I would like to advise you of is
9 I'm not sure MMA is the only one, but I believe Mr. Cutting
10 is up tomorrow and MMA did put in for some oral cross, but
11 has now determined that probably will not be necessary.

12 CHAIRMAN OMAS: If you would just inform our
13 counsel, Mr. Hall, that would be fine. Yes, Mr. Cutting is
14 on schedule for tomorrow.

15 MR. OLSON: Mr. Chairman, Valpak also designated
16 witness Cutting, but we do have questions so I'm sorry, we
17 can't release him.

18 CHAIRMAN OMAS: Okay. That's fine.

19 Mr. Swendiman?

20 MR. SWENDIMAN: Yes. Mr. Chairman, we're going to
21 be -- let me back up a minute. The Postal Service filed the
22 responses of USPS witness Abdirahman last night to GCA's
23 interrogatories which puts it outside the designation date
24 for witnesses tomorrow. We plan to file that by close of
25 business today, our designations of that.

1 Is there anything that you wish for us to do in
2 connection with that since it's going to be out of time
3 based on a day late of filing?

4 CHAIRMAN OMAS: No. That's fine.

5 MR. SWENDIMAN: That's fine.

6 CHAIRMAN OMAS: Mr. Hall, so you have submitted
7 your correction?

8 MR. HALL: Yes.

9 CHAIRMAN OMAS: Without objection, they'll be
10 placed in the record.

11 (The document referred to,
12 previously identified as
13 Exhibit No. XEMMA-1 (revised),
14 was received in evidence.)

15 CHAIRMAN OMAS: Ladies and gentlemen, we'll see
16 you at 1:15.

17 Ms. Robinson, we'd like to thank you for your
18 testimony here today and you're now excused.

19 (Witness excused.)

20 (Whereupon, at 11:49 a.m., the hearing in the
21 above-entitled matter was recessed, to reconvene at 1:15
22 p.m. this same day, Tuesday, June 28, 2005.)

23 //

24 //

25 //

A F T E R N O O N S E S S I O N

(1:23 p.m.)

CHAIRMAN OMAS: Mr. Tidwell, would you please identify your witness so that I can swear him in, please?

MR. TIDWELL: Yes, Mr. Chairman. The Postal Service has called Altaf Taufique to the stand.

Whereupon,

ALTAF TAUFIQUE

having been duly sworn, was called as a witness and was examined and testified as follows:

(The document referred to was marked for identification as Exhibit No. ABA&NAPM/USPS-T28.)

DIRECT EXAMINATION

BY MR. TIDWELL:

Q Mr. Taufique, on the table in front of you are two copies of a document entitled the direct testimony of Altaf Taufique on behalf of the United States Postal Service and designated for purposes of this proceeding as USPS-T28. Have you had a chance to review that document?

A Yes.

Q Was it prepared by you or under your supervision?

A Yes.

Q If you were to provide the contents of that

1 document as your oral testimony today would it be the same?

2 VOICE: Closer to the mike.

3 A Sorry about that..

4 MR. TIDWELL: The Postal Service moves the direct
5 testimony of Altaf Taufique into evidence.

6 CHAIRMAN OMAS: Is there any objection?

7 (No response.)

8 CHAIRMAN OMAS: Being none, so ordered. I will
9 direct counsel to provide the reporter with two copies of
10 the corrected direct testimony of Mr. Taufique. That
11 testimony is received into evidence; however, as is our
12 practice it will not be transcribed.

13 (The document referred to,
14 previously identified as
15 Exhibit No. ABA&NAPM/USPS-T28,
16 was received in evidence.)

17 CHAIRMAN OMAS: Mr. Taufique, have you had an
18 opportunity to examine the packet of designated written
19 cross-examination that was made available to you?

20 THE WITNESS: Yes, sir. I have examined it.

21 CHAIRMAN OMAS: If the questions in the packet
22 were posed to you orally today would your answers be the
23 same as those previously provided in writing?

24 THE WITNESS: Yes, they would except a couple of
25 corrections if I may at this point in time? On Valpak-USPS-

1 T28-21, on page 2 we corrected the numeration of the
2 answers/responses on that page. So the top line is not (b),
3 (b) starts after that. There are only five parts to the
4 question, we've provided six responses actually.

5 So that has been corrected in this copy. On
6 Valpak-USPS-T28-10, subpart (f), the word take should be
7 taken. With those corrections, those would be my answers.

8 CHAIRMAN OMAS: Counsel, would you please provide
9 two copies of the corrected designated written cross-
10 examination of witness Taufique to the reporter? That
11 material is received into evidence and is to be transcribed
12 into the record.

13 (The documents referred to
14 were marked for identification
15 as Exhibit Nos. ABA&NAPM/USPS-
16 T28-1, 3 through 5 and were
17 received in evidence.)

18 (The documents referred to
19 were marked for identification
20 as Exhibit Nos. POIR2,
21 Question 4.)

22 //

23 //

24 //

25 //

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Request of the United States Postal
Service for a Recommended Decision on
Changes in Rates of Postage and Fees for
Postal Services

Docket No. R2005-1

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE
(USPS-T-28)

<u>Party</u>	<u>Interrogatories</u>
American Bankers Association and National Association of Presort Mailers	ABA&NAPM/USPS-T28-1, 3-5 ABA&NAPM/USPS-T21-20a, 56a-f, 62d redirected to T28 GCA/USPS-T28-1 MMA/USPS-T28-1a MMA/USPS-T21-55b redirected to T28 PRC/USPS-POIR No.3- Q1, POIR No.6- Q7 redirected to T28
Greeting Card Association	GCA/USPS-T28-1-3
Major Mailers Association	GCA/USPS-T28-1 MMA/USPS-T28-1a-c, e
Newspaper Association of America	VP/USPS-T28-2, 11, 22, 29, 56
Office of the Consumer Advocate	OCA/USPS-T28-1-12 OCA/USPS-T7-1-5 redirected to T28

Party

Pitney Bowes Inc.

Valpak Direct Marketing Systems,
Inc. and Valpak Dealers' Association
Inc.

Interrogatories

GCA/USPS-T28-1

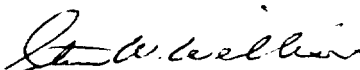
PRC/USPS-POIR No.1- Qb, POIR No.3- Q1,
POIR No.6- Q7 redirected to T28

VP/USPS-T28-6f

PRC/USPS-POIR No.6- Q7 redirected to T28

VP/USPS-T28-1-3, 6f, 7bv, 8f, 9b, g-h, 10-13, 16,
17a-c, 18c-g, 19-20, 21a-b, d-f, 22, 28a, 29, 31-
37, 46a, 47a-f, 52-58

Respectfully submitted,



Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE (T-28)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
ABA&NAPM/USPS-T28-1	ABA&NAPM
ABA&NAPM/USPS-T28-3	ABA&NAPM
ABA&NAPM/USPS-T28-4	ABA&NAPM
ABA&NAPM/USPS-T28-5	ABA&NAPM
ABA&NAPM/USPS-T21-20a redirected to T28	ABA&NAPM
ABA&NAPM/USPS-T21-56a redirected to T28	ABA&NAPM
ABA&NAPM/USPS-T21-56b redirected to T28	ABA&NAPM
ABA&NAPM/USPS-T21-56c redirected to T28	ABA&NAPM
ABA&NAPM/USPS-T21-56d redirected to T28	ABA&NAPM
ABA&NAPM/USPS-T21-56e redirected to T28	ABA&NAPM
ABA&NAPM/USPS-T21-56f redirected to T28	ABA&NAPM
ABA&NAPM/USPS-T21-62d redirected to T28	ABA&NAPM
GCA/USPS-T28-1	ABA&NAPM, GCA, MMA, Pitney Bowes
GCA/USPS-T28-2	GCA
GCA/USPS-T28-3	GCA
MMA/USPS-T28-1a	ABA&NAPM, MMA
MMA/USPS-T28-1b	MMA
MMA/USPS-T28-1c	MMA
MMA/USPS-T28-1e	MMA
MMA/USPS-T21-55b redirected to T28	ABA&NAPM
OCA/USPS-T28-1	OCA
OCA/USPS-T28-2	OCA
OCA/USPS-T28-3	OCA
OCA/USPS-T28-4	OCA
OCA/USPS-T28-5	OCA
OCA/USPS-T28-6	OCA
OCA/USPS-T28-7	OCA
OCA/USPS-T28-8	OCA
OCA/USPS-T28-9	OCA
OCA/USPS-T28-10	OCA
OCA/USPS-T28-11	OCA
OCA/USPS-T28-12	OCA

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY
REDIRECTED FROM WITNESS ABDIRAHMAN**

ABA&NAPM/USPS-T21-56.

- a. Please confirm that in MC95-1, based on its cost models, the USPS proposed an initial "prebarcode" discount for the then-new basic automation rate of 5 cents.
- b. Please confirm that in its O&RD, the Commission set the basic automation discount at a much higher level of 5.9 cents, or 0.9 cents higher than your proposed discount.
- c. Please confirm that in MC95-1, based on its cost models, the USPS proposed a 3 Digit Presort discount of 7 cents.
- d. Please confirm that in its O&RD, the Commission set the 3 Digit Presort discount at a lower level of 6.6 cents, or 0.4 cents lower than your proposed discount.
- e. Please confirm that in MC95-1, based on its cost models, the USPS proposed an initial 5 Digit Presort discount of 8.5 cents.
- f. Please confirm that in its O&RD, the Commission set the 5 Digit Presort discount at a lower level of 8.2 cents, or 0.3 cents lower than your proposed discount.
- g. In light of your answers to a. – f. above please confirm that the net impact of the Commission's changes to your proposed worksharing rates was to emphasize barcoding more and presorting less.

RESPONSE

- a. Confirmed.
- b. Confirmed.
- c. & d. Confirmed, except that the rates cited are for 3-digit *Automation* letters.
- e. & f. Confirmed, except that the rates cited are for 5-digit *Automation* letters.
- g. Not confirmed. The recommended decision in Docket MC95-1 disagrees with the conclusion drawn by your question. In paragraph 5047 of the Opinion and Recommended Decision it is stated: "By recommending rates for discounted categories that reflect savings produced by presortation, preparation to ensure compatibility with automated processing, and other worksharing activities, the

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY**

ABA/NAPM-T28-1. Please refer to Table 1A to your response to POIR No. 3, # 1. Please confirm that the title of this table ("Passthroughs Calculated Using the Postal Service Methodology") refers to the method of calculating the passthrough on the entire discount and not merely on the increment; and that the passthroughs in such Table 1A are based upon the mail processing unit costs from LR -K-110, revised 05/24/05. Please prepare an equivalent table showing the resulting Percentage Passthroughs utilizing the differentials which result from the Worksharing Related Savings which result from Mr. Abdirahman's response to ABA/NAPM-T21-55 [i.e., utilizing delivery unit costs of all First Class Mail Nonautomation Presort Letters as the proxy for delivery unit costs of the benchmark, Metered Letters, as the Commission did in the last non-settled rate case (R-2000-1)].

RESPONSE:

Confirmed that the title of Table 1A prepared in response to POIR No. 3, Question 1 refers to the method of calculating the passthrough on the entire discount and not merely on the increment; and that the passthroughs in this table are based upon the mail processing unit costs from USPS-LR -K-110, revised 05/24/05.

The attached table shows the requested calculation and is based on the assumptions provided in ABA/NAPM-T21-55 to witness Abdirahman.

Table 1A. Passthroughs Calculated Using the Postal Service Methodology¹

	Nonautomation Presort	Mixed AADC	AADC	3-Digit Automation Letters	5-Digit Automation Letters
Single Piece	39.0	39.0	39.0	39.0	39.0
Discounted Rate	37.1	32.6	31.7	30.8	29.3
Discount	1.90	6.40	7.30	8.20	9.70
Benchmark	17.717	17.717	17.717	17.717	17.717
Workshare Unit Cost	25.708	9.072	7.973	7.562	6.237
Differential	-7.991	8.645	9.744	10.155	11.480
Percentage Passthrough	-24%	74%	75%	81%	84%

¹This table has been prepared to respond to interrogatory ABA/NAPM-T28-1. The calculations are the same as Table 1A that was prepared in response to POIR # 3, Q. 1. The cost numbers reflect the assumptions listed in ABA/NAPM interrogatory ABA/NAPM-T21-55 applied to PRC-LR-K-110 as requested in the question.

	Carrier Route Automation Letters Carrier Route
5-Digit	29.3
Discounted Rate	29
Discount	0.30
Benchmark (5-Digit Manual)	9.091
Carrier Route	8.034
Differential	1.056
Percentage Passthrough	28%

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY**

ABA&NAPM/USPS-T28-3. In response to Presiding Officer Information Request Number 6, question 7, dated June 14, 2005, you state "both methods of calculating passthroughs would be equivalent if the incremental method utilizes a 100 [percent] passthrough at each level". Please refer to the attached Tables 1, the original from POIR #6, and the changes made to that table labeled as "From ABA&NAPM."

- a. Please confirm in Table 1 "From ABA&NAPM", that the incremental passthroughs are 100% for rate category B, and also 100%, not 300%, for rate category C.
- b. Please confirm that this new result arises from re-estimating the USPS worksharing cost by +2 for rate category B.
- c. With the data provided in Table 1 "From ABA&NAPM", please show that your method of calculating the passthrough is "equivalent" per your answer quoted above.

RESPONSE

- a. Confirmed, based on the changes made to Table 1 in your interrogatory.
- b. Confirmed.
- c. You have already shown that in your example by showing both approaches in that table.

Response of Postal Service Witness Taufique to POIR No. 6, Question 7 - REVISED JUNE 23, 2005

From POIR #6
Table 1. Comparison of Incremental and Cumulative Passthroughs

Rate Category	USPS Worksharing Cost	Postage Rate	Traditional Approach Incremental			USPS Proposed Approach Cumulative		
			Cost Avoidance	Discount	Passthrough	Cost Avoidance	Discount	Passthrough
A (no w/s)	20	30						
B (some w/s)	13	25	7	5	71%	7	5	71%
C (more w/s)	12	22	1	3	300%	8	8	100%

From ABA&NAPM
Table 1. Comparison of Incremental and Cumulative Passthroughs

Rate Category	USPS Worksharing Cost	Postage Rate	Traditional Approach Incremental			USPS Proposed Approach Cumulative		
			Cost Avoidance	Discount	Passthrough	Cost Avoidance	Discount	Passthrough
A (no w/s)	20	30						
B (some w/s)*	15	25	5	5	100%	5	5	100%
C (more w/s)	12	22	3	3	100%	8	8	100%

* Where source of problem is with rate category B, not C.

From POIR #6
Table 2. Demonstration of Results of Hidden Inefficient Signal

Rate Category	Mailer Expense			Society Costs		
	Mailer Worksharing	Postage Rate	Total	Mailer Worksharing	Postage Rate	Total
A (no w/s)	0	30	30	0	20	20
B (some w/s)	4	25	29	4	13	17
C (more w/s)	6	22	28	6	12	18

From ABA&NAPM
Table 2. Demonstration of Results of Efficient Price Signal

Rate Category	Mailer Expense			Society Costs		
	Mailer Worksharing	Postage Rate	Total	Mailer Worksharing	Postage Rate	Total
A (no w/s)	0	30	30	0	20	20
B (some w/s)	2	25	27	2	15	17
C (more w/s)	4	22	26	4	12	16

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE TO ABA&NAPM INTERROGATORY

ABA&NAPM/USPS-T-28-4. The “hypothetical” raised in POIR #6 with the 300% incremental passthrough is the same as the issue raised in POIR #3, Question 1. Please refer to Table 1 and the calculated 219% incremental passthrough for automated 3 digit presort FCLM, utilizing the residual mail category AADC. As constructed both the hypothetical and the earlier POIR might lead to an inference that considering this one rate making factor alone, the automated 3 digit presort rate might be too low, and the discount associated with it too high.

- a. Please confirm relying on the information in ABA&NAPM-T28-3 above, that an equally plausible inference is that the source of the greater - than - 100% incremental passthrough for hypothetical rate category C [or the automated 3 digit presort rate in this case] is that the USPS worksharing cost for category B [or the AADC rate] is set too low.
- b. Please confirm that adjusting the USPS “worksharing cost” for rate category B in Table 1 “From ABA&NAPM,” causes the incremental passthrough for rate category C to fall from 300% to 100%, and for rate category B to rise from 71% to 100%.
- c. Please confirm that the incremental passthrough changes noted in b. are the result of altering the cost for rate category B and B alone, and that no other factor is changed.
- d. Please confirm that in MC95-1, the Postal Service proposed an initial 26 cent Basic Automation rate for that new rate category while maintaining the single piece rate at 32 cents.
- e. Please confirm that in MC95-1, the Postal Rate Commission in its Opinion and Recommended Decision proposed a 25.1 cent Basic Automation rate, a 0.9 cent lower rate than proposed by the Postal Service, and that this rate was implemented and put into effect.
- f. Please confirm that the incremental passthrough set by the Commission in establishing that initial Basic Automation rate of 25.1 cents was 78%, not 100% (see MC95-1, O&RD, pp. IV-136-IV-137, para [4302]).
- g. Please confirm that to keep its MC95-1 changes to the USPS rate proposals revenue neutral in the FCLM letters subclass, the Commission also raised the 3 Digit and 5 Digit presort rates for automation letter mail above the USPS proposals.
- h. Please confirm that the current mixed AADC and AADC rates used to establish the incremental passthrough in Table 1 of POIR #3, Question 1 are the result of “de-averaging” the Basic Automation rate established in MC95-1.

RESPONSE

- a. The determination of whether a rate is set appropriately depends on a host of factors enumerated in the pricing criteria and other factors as evaluated by the Commission. A single passthrough, whether determined incrementally or for total worksharing, is not the sole criterion on which a rate would be deemed

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY**

RESPONSE to ABA/USPS-T28-4 (continued):

appropriate. If your question addresses solely the issue of an incremental passthrough of greater than 100 percent for 3-Digit First-Class Mail automation letters, it is correct that the incremental passthrough of less than 100 percent at the previous level does affect the incremental passthrough at the 3-Digit level. A passthrough of less than 100 percent results in a relatively lower discount and a relatively higher rate than would be the case with a passthrough equal to 100 percent, all other factors equal. As discussed in my responses to POIR 6, Question 7, appropriate rate design requires the consideration of many factors other than just the incremental passthrough associated with a given level of worksharing.

- b. Confirmed. The adjustment made to worksharing costs results in a change in passthrough for levels B and C and produces a 100 passthrough for both of these levels in your example, as shown in Table 1.
- c. Confirmed.
- d. Not confirmed. The Postal Service proposed a 27-cent rate for First-Class Mail Basic Automation Rate Letters.
- e. Not confirmed. The Commission recommended a rate of 26.1 cents for First-Class Mail Basic Automation. I can confirm that the difference between the rates 27 cents (USPS proposal for Basic Automation) and 26.1 cents (Commission recommendation for Basic Automation) is 0.9 cents.
- f. Confirmed.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY**

RESPONSE to ABA/USPS-T28-4 (continued):

- g. I can neither confirm nor reject the hypothesis. The Commission's recommended decision speaks for itself.
- h. Confirmed. The current Mixed AADC and AADC rate categories are the result of de-averaging First-Class Mail Basic Automation Letter rates in Docket No. R2001-1. I can also confirm that the Basic Automation rate category was established as result of Docket MC95-1.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY**

ABA&NAPM/USPS-T-28-5. In response to Presiding Officer Information Request Number 6, question 7, dated June 14, 2005, you demonstrate that worksharing in your numerical example change to Table 2 "would provide the lowest combined cost to the society". However, your numerical example, by increasing the worksharing cost from 4 to 5.5, produces a total mailer expense of 30.5 for doing the worksharing in rate category B, while the total mailer expense for rate category A with no worksharing is only 30. It is not clear that makes sense, or that worksharing would occur under such circumstance. Please refer to Table 2 "From ABA&NAPM" in the attachment.

- a. Please confirm that the total society costs are lower for rate category C than they are for rate category A or B.
- b. Please confirm that the total mailer expense gets lower and lower, the more worksharing that is done, i.e. A to B, and B to C..
- c. Please confirm that the lowest total society costs exist when the most worksharing is done, i.e. 16 for rate category C.

RESPONSE

The purpose of the example in my response to POIR No. 6, Question 7 was to demonstrate that a different set of cost numbers for the mailer's portion of the work may lead to an opposite result regarding the total cost to the society. I was not intending to provide a set of numbers that realistically represents the worksharing choices that face customers. The purpose of this example was to point out that the Postal Service and the Commission do not know mailer's actual costs. As a result, changes or errors in estimating mailers' costs may appear to make choice C better for the society; however, a true assessment of the actual benefits to society cannot be known because the true value of mailers' costs is unknown.

- a. Confirmed, based on the assumptions used in the example regarding the Postal Service's cost structure, mailer's costs and postage rates.
- b. Confirmed, based on the assumptions used in the example regarding the Postal Service's cost structure, mailer's costs and postage rates.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY**

RESPONSE to ABA/USPS-T28-5 (continued):

- c. Confirmed, based on the assumptions used in the example regarding the Postal Service's cost structure, mailer's costs and postage rates.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY
(REDIRECTED FROM WITNESS ABDIRAHMAN)**

Revised: May 26, 2005

ABA&NAPM/USPS-T21-20. The Commission's POIR #3 at Table 1 shows a passthrough percentage on the spread between FCLM AADC and 3-digit presort letters of 218%, and a corresponding passthrough in Table 3A for a Standard A Regular 3-digit presort letter of 49%.

- a. Please confirm that the difference in passthroughs between 218% and 49% is based in part on using a relatively high cost non-automation presort letter for benchmarking the Standard A 3 digit "costs avoided" versus using a relatively low cost basic automation presort letter for benchmarking the FCLM 3 digit costs avoided.
- b. Please create two columns, one each for the 3 digit FCLM letter and 3 digit Standard A Regular letter, and list each activity, productivity, and unit cost from your mail flow models by 3 digit MODS associated with producing that 3 digit letter in each case.
- c. If differences in these activities in b., or differences in the "costs avoided" benchmark in a. do not fully explain the differences between the above percentages, please break down the difference by percentage difference accounted for, e.g. 30% of the 169% difference is due to factor x, another 40% is due to factor y, etc.

Response:

- a. The Postal Service uses Bulk Metered Mail as the benchmark for estimating worksharing cost savings for First-Class Mail. Using this benchmark, the passthrough for the First-Class 3-Digit automation letter is 107 percent instead of 219 percent (based on the revised cost estimates for First-Class automation letters). See my response to POIR3, Question1. My understanding is that the Commission agrees with the Postal Service methodology. The Opinion and Recommended Decision for Docket No. R2000-1, stated: "The Commission continues to accept bulk metered mail as the appropriate benchmark for determining the worksharing cost savings for First-Class Mail." See PRC Op. R2000-1, page 241, ¶5089.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY
(REDIRECTED FROM WITNESS ABDIRAHMAN)**

Revised: May 26, 2005

Response to ABA&NAPM/USPS-T21-20(a) (continued):

Standard Mail 3-Digit presort letter passthrough is 48 percent (based on the revised cost estimates for Standard Mail automation letters) and uses the 3/5-Digit sorted nonautomation letters category as the benchmark. Please see my response to POIR3, Question 1.

~~b&c. Please see the response of witness Abdirahman, USPS-T-21~~

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY
REDIRECTED FROM WITNESS ABDIRAHMAN**

ABA&NAPM/USPS-T21-62. In your answer to ABA&NAPM/USPS-T21-27, you cite a Commission statement from R2000-1 that "BMM letters is the mail most likely to convert to worksharing."

- a. Are you aware that the RCR read rates for processing single piece letters have increased substantially since R2000-1 due to better camera technology, and that compared to R2000-1, the "calculated total" TY unit mail processing costs for single piece letters has dropped in USPS witness Smith's spread sheets from 12.3 cents in R2000-1 (see LR-I-81) to 11.421 cents in this case (see LR-K-53).
- b. Are you aware that presort bureaus and worksharing mailers also use the improved camera technology that has enabled more successful RCR read rates, and less manual keying in of OCR machine-unreadable addresses?
- c. Please confirm that the difference in unit mail processing costs has shrunk dramatically between BMM/single piece metered and other single piece letters in USPS witness Smith's above referenced TY spreadsheets between R2000-1 and R2005-1, namely from 114.2% of the single piece unit cost (using the s. p. metered letter as reference) in R2000-1 to only 104.7%.
- d. With the cost of processing all single piece letter mail in First Class rapidly converging to the costs of processing metered mail, what practical relevance does any metered mail benchmark (whether bulk or non-bulk) have any longer as a benchmark?
- e. Assuming presort bureaus had equitable access relative to the Postal Service for all collection box mail, including blue boxes, residential mail boxes and other pick-up sources for First Class single piece letter mail, and assuming the costs of sorting BMM and other single piece mail were basically equivalent, please confirm that BMM would be no more likely to "convert to worksharing" than any other First Class single piece letter mail. If you do not confirm please fully explain your answer, including but not limited to a full economic explanation of why the apparent changes in, and convergence of, the relative costs of processing metered versus other single piece letter mail would not act as a strong economic signal for presort bureaus to process USPS collection box mail as willingly as BMM.

RESPONSE

- a-c- Response provided by witness Abdirahman.
- d. I would like to note that in this docket the proposed rates are not based on cost savings estimated by witness Abdirahman (USPS-T-21) so the issue of benchmark to calculate the cost savings is not relevant.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO ABA&NAPM INTERROGATORY
REDIRECTED FROM WITNESS ABDIRAHMAN**

RESPONSE to ABA&NAPM/USPS-T21-62 (continued):

Also, the assumption of convergence of single piece letters and metered mail single piece letters is based on two observations, TY2001 (see LR-I-81) and TY2006 (See LR-K-53). One additional observation from TY2003 (see LR-J-53) used in Docket No. 2001-1 may not necessarily support the hypothesis of convergence. It is possible that cost estimates for these two mail streams may continue to converge. If that appears to be the case, the Postal Service and the Commission may have to evaluate the benchmark issue in the context of a traditional case, in light of the totality of other circumstances of that particular filing.

During past three omnibus rate cases, Bulk Metered Mail (BMM) was the Commission approved benchmark for First-Class Mail categories. Please see PRC Op., R2000-1, paragraph 5089, which states that the Commission "also views a benchmark as a "two-way street." It represents not only that mail most likely to convert to worksharing, but also, to what category current worksharing mail would be most likely to revert if the discounts no longer outweigh the cost of performing the worksharing activities."

~~e. The assumption of a private presort bureau being able to collect the mail directly from postal collection boxes and residential mail boxes does not reflect the current framework guiding the workings of the Postal Service. A significant change in this framework would be needed for these assumptions~~

Revised May 11, 2005

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION

GCA/USPS-T28-1. Please refer to pages 4-6 and Table 1 of your prepared testimony, USPS-T28. USPS witnesses Potter (USPS-T1, pp 4-5, 7) and Robinson (USPS-T27, pp. 6-8) state the purpose of this case is to raise sufficient additional revenue to discharge the Public Law 108-18 escrow obligation, by means of substantially equal increases for substantially all categories. In view of this purpose, what is the rationale for enlarging the discount for certain First-Class Presorted and Automation heavy pieces? In addition to explaining this rationale, please furnish any documents in which such rationale or the considerations underlying its development are set forth.

RESPONSE:

Generally speaking, all discounts were increased by the overall across-the-board increase of 5.4 percent to ensure that the resulting discounted rates were increased by the same percent, with due regard for rounding constraints for the various rate cells.

If the discounts were held at the current level, while the base from which the discounts are calculated (i.e., the First-Class Mail single piece rate) was increased by 5.4 percent, then the discounted rates would increase by a substantially higher percent than the 5.4 percent target. For example, the attached Excel sheet shows the impact of holding the discounts at the current level. The First-Class Mail nonautomation presort rate would increase by 5.7 percent, compared to the proposed increase of 5.4 percent. Mixed AADC, AADC, 3-Digit and 5-Digit Automation Letter rates would increase by 6.5, 6.6, 6.8, and 7.2 percent, respectively compared to the proposed increases of 5.5, 5.3, 5.5, and 5.4 percent, respectively.

The example of a 4 ounce piece provided in the attached sheet also demonstrates that if the heavy-piece discount is kept constant while other rates increase by 5.4 percent, the postage impact on the 4 ounce piece is higher than 5.4 percent.

Revised May 11, 2005

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION

Response to GCA/USPS-T28-1, Page 2 of 2

We believe that it is fair and equitable for these mail categories to pay the same percent increase as all other rate categories in the subclass. I would also note that, although workshared First-Class Mail is not a subclass, the proposal along the lines suggested in your question would cause these workshare rate categories, which have an implicit cost coverage exceeding all of the subclasses and whose unit cost has in fact declined 2.8 percent (between FY2000 and FY2004), to bear a disproportionate share of the escrow burden.

Attachment to GCA/USPS-T28-1

RATE CHANGES WITH CONSTANT DISCOUNTS

Presorted and Automation Rates

	Current Rate	Proposed Rate w/constant Discounts	Percent Change (Col. D/Col.B)-1
Single-Piece	0.37	0.39	Not Applicable
Presorted			
First Ounce	0.352	0.372	5.7%
Discount	0.018		
Automation Letters			
Mixed AADC	0.309	0.329	6.5%
Discount	0.061		
AADC	0.301	0.321	6.6%
Discount	0.069		
3-Digit	0.292 0.078	0.312	6.8%
5-Digit	0.278 0.092	0.298	7.2%
Automation Heavy Pieces			
	4 Ounce Automation Piece - 3 Digit Presort		
	Current	Proposed w/constant Heavy Pc. Discount	
First Ounce	0.292	0.308	
Additional Ounces	0.675	0.711	
Heavy Piece Discount	-0.041	-0.041	
	0.926	0.978	5.6%

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION

GCA/USPS-T28-2. Did the Postal Service estimate the amount of revenue that would be forgone by increasing the heavy-piece discount referred to in Interrogatory GCA/USPS-T28-1? If your answer is not an unqualified "no," please provide such estimate and any and all underlying calculations.

RESPONSE:

No. The total revenue resulting from the proposed First-Class Mail Letters and Sealed Parcels subclass would not necessarily be different. In general, rates are proposed that meet a revenue target for a subclass as a whole. If, as in your hypothetical, the heavy-piece discount were not increased (i.e., rates for heavy pieces were higher), it is likely that there would have been reductions in some other rates in the Letters and Sealed Parcels subclass. The Postal Service did not estimate the revenue effect of not increasing the heavy-piece discount as suggested by interrogatory GCA/USPS-T28-1, holding other proposed rates constant. The calculation is fairly simple and is provided in the attached sheet. The amount is estimated to be approximately \$760,000, assuming no additional volume effect. Please see the attached sheet for the simple calculation that utilizes the estimate of TYAR heavy-pieces and takes the difference between the product of this estimated volume and the existing discount, and the product of the estimated volume and the proposed discount.

Attachment to GCA/USPS-T28-2

Heavy Pieces - USPS28Aspreadsheets.xls, worksheet FM-4

	TYAR Volume	Current Discount	Proposed Discount
Nonautomation Presort	72,133		
Automation Presort Letters	90,719		
Automation Presort Flats	216,089		
Automation Carrier Route Letters	734		
Total	379,675	0.041	0.043
		\$ 15,567	\$ 16,326
Difference	759		

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORIES OF THE GREETING CARD ASSOCIATION

GCA/USPS-T28-3. Did the Postal Service estimate the amount of revenue that would be obtained by raising the non-machinable surcharge for single-piece First-Class letters from 12 cents to 13 cents? If your answer is not an unqualified "no," please provide such estimate and any and all underlying calculations.

RESPONSE:

No. The total revenue resulting from the proposed First-Class Mail Letters and Sealed Parcels subclass would not necessarily be different. In general, rates are proposed that meet a revenue target for a subclass as a whole. If, as in your hypothetical, the single-piece nonmachinable surcharge were not increased (i.e., rates for nonmachinable single-pieces were lower), it is likely that there would have been increases in some other rates in the Letters and Sealed Parcels subclass. The Postal Service did not estimate the amount of revenue that would be obtained by raising the non-machinable surcharge for single-piece First-Class Mail letters from 12 cents to 13 cents, holding all other proposed rates constant. The calculation is fairly simple and is provided in the attached sheet. The amount obtained is estimated to be approximately \$4.8 million, assuming no additional volume impact. Please see the attached sheet for the simple calculation that utilizes the estimate of TYAR non-machinable pieces and takes the difference between the product of the estimated volume and the existing surcharge, and the product of the estimated volume and the proposed surcharge.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF MAJOR MAILERS ASSOCIATION,
REDIRECTED FROM WITNESS ABDIRAHMAN

MMA/USPS-T21-55

Please refer to your response to Interrogatory MMA/USPS-T21-12, which sought information regarding your knowledge of specific enumerated workshare activities performed by a High Volume (HV) First-Class workshare mailer (defined as a mailer that mails on its own behalf and/or on behalf of other First-Class mailers at least 5 million pieces per month). In your response, you state "I am not an expert on how HV workshare mailers perform their internal mail preparation operations, nor is it necessary for me to understand the mailer's [sic] Activities."

- A. Please explain how you can possibly provide accurate estimates of postal cost savings due to worksharing if you do not understand nor are you familiar with the specific requirements, in addition to those listed in postal regulations, that comprise worksharing?
- B. Please explain your view of how changes in technology have changed the nature and extent of mailer worksharing over the past ten years.

RESPONSE:

- A. To capture the savings associated with workshare mail, that mail must be presented in compliance with postal requirements. However, different customers may use different methods to meet the requirements.

Consequently Postal Service analysts may not know all the specific mail preparation activities that high volume or other mailers undertake to meet postal requirements. But our analysts are well aware of how mail qualifying for specific rates is presented to the Postal Service and its implication on Postal Service operations.
- B. Mail processing technology both within and outside the Postal Service has changed tremendously over the last few years. The role of technology combined with rate incentives has led to increased worksharing in all classes of mail.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO MAJOR MAILERS ASSOCIATION INTERROGATORY**

577

MMA/USPS-T28-1. Please refer to your proposed rates for First-Class letters, especially as they pertain to the first and second ounces.

A. Please confirm that the Postal Service has proposed to increase the rate digression between the first ounce and second ounce for First-Class letters. If you cannot confirm, please explain.

B. Please review the following table of current and proposed rates and digressions between and either confirm that the numbers are correct or make any necessary corrections.

First-Class Rate Category	Current First-Ounce Rate	Current Second -Ounce Rate	Current Rate Digression	Proposed First-Ounce Rate	Proposed Second-Ounce Rate	Proposed Rate Digression
Single Piece	37.0	23.0	62%	39.0	24.0	65%
Presorted	35.2	22.5	64%	37.1	23.7	67%
Mixed AADC	30.9	22.5	73%	32.6	23.7	77%
AADC	30.1	22.5	75%	31.7	23.7	79%
3 Digit	29.2	22.5	77%	30.8	23.7	81%
5 Digit	27.8	22.5	81%	29.3	23.7	85%
Carrier Route	27.5	22.5	82%	29.0	23.7	86%

C. Please confirm that for standard automation and regular letters, the rate digression between the first and second ounces is 0 %. If you cannot confirm, please explain.

D. Please explain the rationale for increasing the rate digression between the first and second ounces for single piece and workshare First-Class letters.

E. Please explain the rationale for why First-Class workshare letters should have a significantly higher rate digression between the first and second ounces than single piece letters have.

RESPONSE:

A. Confirmed. I would note that the percentage calculation of degression is different from any other discussions in the past by the Postal Rate Commission and the Postal Service, to the best of my knowledge. Instead, degression has always been defined as the absolute gap between the first ounce rate and the additional ounce rate. In this case, that gap has increased in every instance. Also, I would note that if degression is defined as the ratio of the additional ounce rate to the first-ounce rate, then the proposed rate degression would be the same as the

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO MAJOR MAILERS ASSOCIATION INTERROGATORY**

578

RESPONSE to MMA/USPS-T28-1, Page 2 of 3:

current rate depression in the table provided, e.g., 23 cents divided by 37 cents provides ratio of 62 percent, which is the same as 24 cents divided by 39 cents.

B. Not confirmed. I have provided two corrected tables. The first, Table A, uses the definition of depression used in your question. The second, Table B, uses the definition of depression commonly used by the Postal Service and the Commission. Also I have changed the headings "Current Second-Ounce Rate" and "Proposed Second-Ounce Rate" to "Current Additional-Ounce Rate" and "Proposed Additional-Ounce Rate."

Table A

First-Class Rate Category	Current First-Ounce Rate	Current Additional-Ounce Rate	Current Rate Depression	Proposed First-Ounce Rate	Proposed Additional-Ounce Rate	Proposed Rate Depression
Single Piece	37.0	23.0	62%	39.0	24.0	62%
Presorted	35.2	22.5	64%	37.1	23.7	64%
Mixed AADC	30.9	22.5	73%	32.6	23.7	73%
AADC	30.1	22.5	75%	31.7	23.7	75%
3 Digit	29.2	22.5	77%	30.8	23.7	77%
5 Digit	27.8	22.5	81%	29.3	23.7	81%
Carrier Route	27.5	22.5	82%	29.0	23.7	82%

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO MAJOR MAILERS ASSOCIATION INTERROGATORY**

579

RESPONSE to MMA/USPS-T28-1, Page 3 of 3:

Table B

First-Class Rate Category	Current First- Ounce Rate	Current Additional- Ounce Rate	Current Rate Degressi on	Proposed First- Ounce Rate	Propos ed Additio nal- Ounce Rate	Proposed Rate Degressi on
Single Piece	37.0	23.0	14.0	39.0	24.0	15
Presorted	35.2	22.5	12.7	37.1	23.7	13.4
Mixed AADC	30.9	22.5	8.4	32.6	23.7	8.9
AADC	30.1	22.5	7.6	31.7	23.7	8.0
3 Digit	29.2	22.5	6.7	30.8	23.7	7.1
5 Digit	27.8	22.5	5.3	29.3	23.7	5.6
Carrier Route	27.5	22.5	5.0	29.0	23.7	5.3

- C. Confirmed. It is also worth noting that the Standard Mail rate structure is considerably different in many other respects. As such, it is difficult to look at the rate degression issue in isolation.
- D. Redirected to witness Robinson.
- E. I do not agree with the definition of rate degression used in your question. Based on the traditional definition (absolute difference between the first-ounce and additional-ounce rates), the rate degression actually shrinks as the level of workshare increases. This relationship changes because the workshare discounts are based upon cost avoidance and are applied to the first-ounce rates rather than the additional ounce rates.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T28-1. Please refer to your testimony, Tables 11 and 12, the "Summary of Revenues" for the test year before rates and after rates, respectively. Please provide the "Summary of Revenues" for Fiscal Years 2004 and 2005 in the same manner as the test year before rates and after rates "Summary of Revenues" shown in Exhibit USPS-28A, Tables 11 and 12.

Response:

The summaries of revenues for Fiscal Years 2004 and 2005 are attached to this response.

Attachment to
OCA/USPS-T28-1

Page 1 of 6

SUMMARY OF REVENUES
FISCAL YEAR 2004
(thousands)

MAIL SERVICE	Volume ¹	Postage plus Unallocated Fees ¹	Fees ¹	Postage Plus Allocated Fees	Revenue per Piece
First-Class Mail					
Letters Subclass					
Single Piece Letters	45,161,746	20,480,266	246,608	\$20,726,874	0.4589
Non-Automation Presort	2,159,312	875,945		875,945	0.4057
Automated and Carrier Route	45,174,506	13,593,917		13,593,917	0.3009
NSA Adjustment ²	68,385	(2,143)		(2,143)	(0.0313)
Total Worksharing	47,333,818	14,469,862	35,526	14,505,388	0.3064
Total Letters Subclass	92,495,564	34,950,128	282,134	35,232,262	0.3809
Cards Subclass					
Post Cards - Single	2,525,931	601,675	13,011	614,686	0.2434
Non-Automated Presort Cards	394,264	83,559		83,559	0.2119
Automated and Carrier Route Post Car	2,510,637	456,286		456,286	0.1817
Total Worksharing Cards	2,904,901	539,845	2,170	542,015	0.1866
Total Cards Subclass	5,430,832	1,141,520	15,181	1,156,701	0.2130
Business Reply Fees		221,834	(221,834)	-	
Domestic Mail Fees		75,481	(75,481)	-	
Total First-Class Mail	97,926,396	36,388,963	-	36,388,963	0.3716
First-Class Mail postage =		36,091,648			
Priority Mail					
Priority Mail	848,633	4,419,823	1,666	4,421,489	5.2101
Domestic Mail Fees		1,666	(1,666)	-	
Total Priority Mail	848,633	4,421,489	-	4,421,489	5.2101
Express Mail	54,123	852,800	-	852,800	15.7567
Periodicals					
In-County	760,020	71,950	1,640	73,590	0.0947
Outside County					
Regular-Rate	6,462,076	1,753,513	13,947	1,767,460	0.2735
Nonprofit	1,850,746	330,511	3,994	334,505	0.1807
Classroom	62,430	15,926	135	16,061	0.2573
Total Outside County	8,375,252	2,099,951	18,076	2,118,027	0.2529
Domestic Mail Fees		19,716	(19,716)		
Total Periodicals	9,135,272	2,191,617	-	2,191,617	0.2399
Periodicals postage =		2,171,901			

SUMMARY OF REVENUES
FISCAL YEAR 2004
(thousands)

MAIL SERVICE	Volume ¹	Postage plus Unallocated Fees ¹	Fees ¹	Postage Plus Allocated Fees	Revenue per Piece
Standard Mail					
Regular and Nonprofit					
Regular	50,776,236	11,109,644	15,354	11,124,998	0.2191
Nonprofit	11,791,584	1,553,226	52,041	1,605,267	0.1361
Total Regular and Nonprofit	62,567,820	12,662,870	67,395	12,730,265	0.2035
Enhanced Carrier Route and NECR					
Enhanced Carrier Route	30,345,448	5,108,781	9,176	5,117,957	0.1687
Nonprofit Enhanced Carrier Route	2,650,253	243,189	11,697	254,886	0.0962
Total ECR and NECR	32,995,701	5,351,970	20,873	5,372,843	0.1628
Bulk Mailing Fees		61,252	(61,252)		
Domestic Mail Fees		27,016	(27,016)		
Total Standard Mail	95,563,521	18,103,108	0	18,103,108	0.1894
Package Services					
Parcel Post					
Non Destination Entry	109,963	688,228			
Destination Entry	265,655	553,868			
Total Parcel Post	375,618	1,242,096	910	1,243,005	3.3092
Bound Printed Matter	553,666	583,229	1,122	584,350	1.0554
Media Mail	186,229	348,705	536	349,240	1.8753
Library Rate	16,415	30,297	84	30,380	1.8507
Domestic Mail Fees		2,198	(2,198)	-	
Special Handling		436	(436)	-	
Parcel Airlift Fees		17	(17)	(0)	
Total Package Services	1,131,928	2,206,976	0	2,206,976	1.9497
US Postal Service Mail	529,326	0	0	-	-
Free Mail for the Blind and Handicapped	71,082	0	0	-	-
Total Domestic Mail	205,260,281	\$ 64,164,952	\$ 0	\$ 64,164,952	0.3126

SUMMARY OF REVENUES
FISCAL YEAR 2004
(thousands)

MAIL SERVICE	Volume ¹	Postage plus Unallocated Fees ¹	Fees ¹	Postage Plus Allocated Fees	Revenue per Piece
Special Services					
Registry	5,009	56,560		56,560	11.2916
Insurance	51,514	122,467		122,467	2.3774
COD	1,905	11,235		11,235	5.8978
Certified Mail	273,701	629,512		629,512	2.3000
Delivery Confirmation	590,598	67,130		67,130	0.1137
Signature Confirmation	8,743	13,744		13,744	1.5719
Money Orders ³	187,211	236,268		236,268	1.2620
Return Receipts	242,166	456,132		456,132	1.8835
Stamped Cards	96,807	1,936		1,936	0.0200
Stamped Envelopes	334,374	20,000		20,000	0.0598
Box/Caller Service	15,080	779,877		779,877	51.7161
Other ⁴		19,788		19,788	n/a
Total Domestic Special Services	1,807,108	2,414,649		2,414,649	1.3362
Total Mail & Services	205,260,281	\$ 66,579,601		\$66,579,601	

Notes:

¹ Library Reference K-77, Billing Determinants, with Special Service fee revenues from LR-K-115, USPST28C.

² Library Reference K-115, Worksheets FCM5 to FCM11

³ Money order revenues include imputed interest of \$8,344,905.

⁴ Other Special Services Fees

Address Changes to Election Boarc	144
Bulk Parcel Return Service	4,185
Correction of Mailing Lists	108
Meter Service	534
Permit Imprint Permits	7,241
Restricted Delivery	7,549
Shipper Paid Forwarding	4
ZIP Coding of Mailing Lists	23

**Attachment to
OCA-USPS-T28-1**

Page 4 of 6

**SUMMARY OF REVENUES
FISCAL YEAR 2005
(thousands)**

MAIL SERVICE	Volume ¹	Postage plus Unallocated Fees ²	Fees ²	Postage Plus Allocated Fees ²	Revenue per Piece
First-Class Mail					
Letters Subclass					
Single Piece Letters	44,264,888	20,073,675	247,330	\$20,321,005	0.4591
Non-Automation Presort	1,870,606	758,930		758,930	0.4057
Automated and Carrier Route	46,996,836	14,144,043		14,144,043	0.3010
NSA Adjustment ³	19,278	2,943		2,943	0.1527
Total Worksharing	48,886,720	14,905,916	36,517	14,942,433	0.3057
Total Letters Subclass	93,151,608	34,979,591	283,847	35,263,438	0.3786
Cards Subclass					
Post Cards - Single	2,517,501	599,654	13,323	612,977	0.2435
Non-Automated Presort Cards	348,444	73,848		73,848	0.2119
Automated and Carrier Route Post Car	2,607,765	473,912		473,912	0.1817
Total Worksharing Cards	2,956,209	547,760	2,198	549,958	0.1860
Total Cards Subclass	5,473,710	1,147,414	15,521	1,162,935	0.2125
Business Reply Fees		223,364	(223,364)	-	
Domestic Mail Fees		76,004	(76,004)	-	
Total First-Class Mail	98,625,318	36,426,373	-	36,426,373	0.3693
First-Class Mail postage =		36,127,005			
Priority Mail					
Priority Mail	846,257	4,407,442	1,664	4,409,106	5.2101
Domestic Mail Fees		1,664	(1,664)	-	
Total Priority Mail	846,257	4,409,106	-	4,409,106	5.2101
Express Mail	54,111	849,080	-	849,080	15.6916
Periodicals					
In-County	766,554	72,580	1,654	74,234	0.0916
Outside County					
Regular-Rate	6,459,821	1,755,371	13,941	1,769,312	0.2739
Nonprofit	1,874,816	334,931	4,046	338,977	0.1808
Classroom	64,945	16,570	140	16,710	0.2573
Total Outside County	8,399,583	2,106,872	18,127	2,124,999	0.2530
Domestic Mail Fees		19,781	(19,781)		
Total Periodicals	9,166,137	2,199,234	-	2,199,234	0.2399
Periodicals postage =		2,179,453			

**Attachment to
OCA-USPS-T28-1**

Page 5 of 6

**SUMMARY OF REVENUES
FISCAL YEAR 2005
(thousands)**

MAIL SERVICE	Volume ¹	Postage plus Unallocated Fees ²	Fees ²	Postage Plus Allocated Fees ²	Revenue per Piece
Standard Mail					
Regular and Nonprofit					
Regular	53,932,691	11,685,722	16,314	11,702,036	0.2170
Nonprofit	11,973,042	1,566,601	9,766	1,576,367	0.1317
Total Regular and Nonprofit	65,905,733	13,252,323	26,080	13,278,403	0.2015
Enhanced Carrier Route and NECR					
Enhanced Carrier Route	32,297,014	5,454,934	52,842	5,507,776	0.1705
Nonprofit Enhanced Carrier Route	3,264,201	310,198	14,406	324,604	0.0994
Total ECR and NECR	35,561,214	5,765,132	67,248	5,832,380	0.1640
Bulk Mailing Fees		64,638	(64,638)		
Domestic Mail Fees		28,690	(28,690)		
Total Standard Mail	101,466,947	19,110,783	-	19,110,783	0.1883
Package Services					
Parcel Post					
Non Destination Entry	113,242	707,206			
Destination Entry	252,069	521,447			
Total Parcel Post	365,311	1,228,653	888	1,229,541	3.3657
Bound Printed Matter	571,586	602,106	1,158	603,264	1.0554
Media Mail	184,324	345,137	530	345,667	1.8753
Library Rate	16,352	30,179	83	30,262	1.8507
Domestic Mail Fees		2,216	(2,216)	-	
Special Handling		426	(426)	-	
Parcel Airlift Fees		17	(17)	-	
Total Package Services	1,137,573	2,208,734	-	2,208,734	1.9416
US Postal Service Mail	666,104	0	0	-	-
Free Mail for the Blind and Handicapped	72,778	0	0	-	-
Total Domestic Mail	212,035,225	\$65,203,310	\$ -	\$65,203,310	0.3075

**Attachment to
OCA-USPS-T28-1**

Page 6 of 6

**SUMMARY OF REVENUES
FISCAL YEAR 2005
(thousands)**

MAIL SERVICE	Volume ¹	Postage plus Unallocated Fees ²	Fees ²	Postage Plus Allocated Fees ²	Revenue per Piece
Special Services					
Registry	4,412	46,563		46,563	10.5529
Insurance	42,547	101,080		101,080	2.3757
COD	1,710	10,085		10,085	5.8988
Certified Mail	272,612	627,008		627,008	2.3000
Delivery Confirmation	662,412	75,293		75,293	0.1137
Signature Confirmation	8,707	13,687		13,687	1.5720
Money Orders ⁴	183,861	236,795		236,795	1.2879
Return Receipts	243,960	458,769		458,769	1.8805
Stamped Cards	84,765	1,695		1,695	0.0200
Stamped Envelopes	400,000	15,770		15,770	0.0394
Box/Caller Service	15,762	815,149		815,149	51.7155
Other ⁵		20,009		20,009	n/a
Total Domestic Special Services	1,920,749	2,421,903		2,421,903	1.2609
Total Mail & Services	212,035,225	\$ 67,625,213		\$67,625,213	

Notes:

- ¹ USPS-T-7, Attachment A, pages 1-2
- ² Totals for subclasses and Special Services match the totals in Exhibit USPS-27C
- ³ Library Reference K-115, Worksheets FCM5 to FCM11
- ⁴ Money order revenues include imputed interest of \$8,195,579.
- ⁵

<u>Other Special Services</u>	<u>Fees</u>
Address Changes to Election Board	144
Bulk Parcel Return Service	4,445
Correction of Mailing Lists	100
Meter Service	534
Permit Imprint Permits	7,241
Restricted Delivery	7,519
Shipper Paid Forwarding	4
ZIP Coding of Mailing Lists	23

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T28-2. Please refer to LR-K-115, USPST28Aspreadsheets.xls, worksheet "FCM-9 Cap One," showing the Capital One volume and average discount.

- a. For Fiscal Years 2005, 2006, 2007, and 2008, please show the derivation of the Capital One's volume estimate. Provide citations to all figures used, and explain all assumptions.
- b. Please explain the purpose and use of estimates for Capital One's volumes for Fiscal Years 2007 and 2008 in this proceeding.
- c. Please confirm that Capital One's estimated annual volume on which discounts were paid in FY2004 was 63,862,895 (69,184,803 / 13 * 12). See Docket No. MC2002-2, Data Collection Report, January 31, 2005, at Appendix A: page 1. If you do not confirm, please explain.

Response:

- a. The volume estimates for Capital One are derived from the base year 2004 Billing Determinants. Library Reference K-77 (FY 2004 Billing Determinants --, spreadsheet "First-Class Mail BD2004", - worksheet "A-9 NSA Discounts") contains the base year information which was kept constant for subsequent years.
- b. Capital One volumes for Fiscal Years 2007 and 2008 are not used. The distribution of Bank One and Discover volumes was done for FY 2007 and 2008. To keep the format consistent, Capital One volumes were also presented for two years after the test year.
- c. Not confirmed. The discounts were paid on the volume estimate of 69,184,803 for the thirteen month period (September 2003 to September 2004), as they were reported in the data collection report referred to in your question. The volume figure provided in LR-K-77 (referenced above in part a) is based on actual reports for the months October 2003 to September 2004, comprising FY2004.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T28-3. Please refer to LR-K-115, USPST28Aspreadsheets.xls, worksheet "FCM-6 Discover AR," and the line "Revenue Lost."

- a. Please confirm that the amount of "Revenue Lost" for FY 2005 should be \$1,711,125. If you do not confirm, please explain.
- b. Please explain the purpose and use of estimates for Discover's volumes and incremental revenue for Fiscal Years 2007 and 2008 in this proceeding.

Response:

- a. Confirmed. The rate and fee proposals in this docket would go into affect in FY2006, and thus would not have any impact on the revenue lost calculation for FY 2005.
- b. The volumes for FY 2007 and 2008 are not being used. The distribution of Year1, Year2, and Year3 NSA volumes were reported even though some of these volumes affect years beyond the test year.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T28-4. Please refer to LR-K-115, USPST28Aspreadsheets.xls, worksheet "FCM-8 Bank One AR," and the line "Revenue Lost (Standard Mail)."

- a. Please confirm that the amount of "Revenue Lost (Standard Mail)" for FY 2005 should be \$1,686,368. If you do not confirm, please explain.
- b. Please explain the purpose and use of estimates for Bank One's volumes and incremental revenue for Fiscal Years 2007 and 2008 in this proceeding.

Response:

- a. Confirmed. The rate and fee proposals in this docket would go into effect in FY2006, and thus would not have any impact on the revenue lost calculation for FY 2005.
- b. The volumes for FY 2007 and 2008 are not being used. The distribution of Year1, Year2, and Year3 volumes were reported even though some of these volumes affect years beyond the test year.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T28-5. Please refer to USPS-LR-K-115, worksheet "FMC-2," and the Base Year Volume for the Letters Subclass by Rate Category.

- a. Please confirm that the number of "Additional Ounces" in row (d) should be 15,004,298, the estimate shown by Witness Thress. If you do not confirm, please explain.
- b. Please explain why the Base Year Volume of "Single-Piece Letters" of 45,160,847, representing the sum of the single-piece first-ounce and qualified business reply mail first-ounce, does not equal the RPW total for single-piece volume of 45,161,746 shown by witness Thress.

Response:

- a. Not Confirmed. The total in row (d) is correct. The total reflects Additional Ounces for Single-Piece Letters (15,004,298), and Qualified Business Reply Mail Additional Ounces (5,390).
- b. The Base Year Volume of "Single-Piece Letters" does not include the Absentee Ballot volume of 899,000 pieces.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF THE OFFICE OF THE CONSUMER ADVOCATE

OCA/USPS-T28-6. Please refer to USPS-LR-K-115, worksheet "FMC-2," and the Base Year Volume for the Letters Subclass by Rate Category. Please confirm that the note for row (bb), explaining the calculation of the "Total Pieces Letters Subclass," should read $(a) + (f) + (l) + (r) + (x)$. If you do not confirm, please explain.

Response:

Not confirmed. The calculation as stated, using $(a) + (f) + (k) + (x)$, is correct. The sum of (l) and (r) equal (k) , which is included in the calculation as stated.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-7, Page 2 of 2

However, the revenues used in the billing determinants are aggregates from the special reports that are derived from the Revenue, Pieces, and Weight Adjustment Report System. These revenues often do not exactly match revenues computed by multiplying volumes by rates or fees.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-7. Please refer to USPS-LR-K-115, worksheet "SS-28 Registered Mail," and cell "AA20," which shows for FY 2004 "Domestic Fees" of \$52,794,628. Please confirm that for FY 2004 Domestic Fees from Registered Mail transactions, excluding Handling Charges, with and without insurance should be \$52,794,754, as shown in the table below. If you do not confirm, please explain and show all calculations reconciling the difference.

REGISTRY MAIL GOVERNMENT FISCAL YEAR 2004						
Value Up To	Without Postal Insurance			With Postal Insurance		
Domestic	Fee	Transactions	Revenue	Fee	Transactions	Revenue
\$100	\$7.50	1,659,547	\$12,446,604	\$8.00	398,244	\$3,185,954
500				\$8.85	506,413	\$4,481,759
1,000				\$9.70	412,720	\$4,003,385
2,000				\$10.55	527,119	\$5,561,108
3,000				\$11.40	292,745	\$3,337,296
4,000				\$12.25	168,698	\$2,066,549
5,000				\$13.10	260,884	\$3,417,579
6,000				\$13.95	127,123	\$1,773,363
7,000				\$14.80	49,217	\$728,404
8,000				\$15.65	50,380	\$788,443
9,000				\$16.50	54,256	\$895,227
10,000				\$17.35	62,602	\$1,086,146
11,000				\$18.20	29,719	\$540,893
12,000				\$19.05	31,972	\$609,063
13,000				\$19.90	19,754	\$393,101
14,000				\$20.75	11,381	\$236,151
15,000				\$21.60	35,344	\$763,436
16,000				\$22.45	9,707	\$217,915
17,000				\$23.30	8,606	\$200,516
18,000				\$24.15	19,771	\$477,470
19,000				\$25.00	7,394	\$184,843
20,000				\$25.85	61,474	\$1,589,110
21,000				\$26.70	3,470	\$92,659
22,000				\$27.55	8,349	\$230,022
23,000				\$28.40	3,141	\$89,208
24,000				\$29.25	9,907	\$289,791
25,000				\$30.10	103,281	\$3,108,762
		1,659,547	\$12,446,604		3,273,672	\$40,348,150
TOTAL TRANSACTIONS W AND W/O INSURANCE					4,933,219	
TOTAL DOMESTIC FEE REVENUE						\$52,794,754

RESPONSE:

Not confirmed. The calculations in the table, with respect to multiplication of the fee by the respective volume to arrive at the associated revenue, appear to be correct.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-8. Please refer to USPS-LR-K-115, and the worksheet "SS-28 Registered Mail."

- a. For Fiscal Year (FY) 2001, 2002, and 2003, please provide for Registered Mail the number of transactions covered by postal insurance at each level of value.
- b. For FY 2001, 2002, and 2003, please provide for Registered Mail the number of transactions not covered by postal insurance.
- c. For FY 2001, 2002, and 2003, please provide for Registered Mail the number of handling charges.

RESPONSE:

- a-c. See table below.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-8, Page 2 of 2

**Registered Mail Transactions by Value Level,
FY 2001 to 2003 (Source: Billing Determinants)**

	Transactions		
	2001	2002	2003
Without Insurance			
No Value	2,375,278	2,120,828	1,754,784
With Insurance -			
Value Up To			
\$100	713,493	441,771	402,504
500	1,133,735	820,183	599,168
1,000	871,551	639,778	597,042
2,000	690,531	579,208	499,253
3,000	410,428	367,304	378,113
4,000	251,628	167,679	226,410
5,000	306,231	176,382	161,262
6,000	123,062	144,714	117,535
7,000	83,816	93,906	71,255
8,000	102,363	69,255	63,668
9,000	61,117	45,702	40,244
10,000	132,604	89,637	119,212
11,000	50,125	43,996	47,077
12,000	46,719	33,205	21,610
13,000	25,292	43,834	23,632
14,000	34,212	26,739	14,974
15,000	54,261	42,730	37,845
16,000	19,653	19,192	21,331
17,000	17,701	10,050	16,254
18,000	14,536	18,030	17,416
19,000	14,203	18,145	17,721
20,000	41,615	31,673	41,867
21,000	12,877	6,910	8,150
22,000	18,714	18,884	10,307
23,000	8,440	10,027	11,578
24,000	18,691	14,258	11,433
25,000	93,939	91,674	74,316
Sub Total	7,726,815	6,185,694	5,405,958
Handling Charges	96,123	91,068	81,191
Total	7,822,938	6,276,762	5,487,150

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-9. Please refer to USPS-LR-K-115, worksheet "SS-28 Registered Mail," and cell "AA21," which shows for FY 2004 "Handling Charges" of \$3,765,085. Please show all calculations used to derive Handling Charges, and provide sources for all figures.

RESPONSE:

The Handling Charges revenue and volume are presented in the Billing Determinants, USPS-LR-K-77, page K-6. The revenue and volume is derived from a special report produced using data from the Revenue, Pieces and Weight Adjustment Report System.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-10. Please refer to USPS-LR-K-115, worksheet "SS-28 Registered Mail," and cells "AH19" and "AH21," which shows TYBR and TYAR volume forecasts of 3.990 and 3.738, respectively. Please provide a source for these volume forecasts.

RESPONSE:

The source for the TYBR and TYAR volume forecasts are Exhibit USPS-7A, pages 4 and 7, respectively.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-11. Please refer to USPS-LR-K-115, and the worksheet "SS-28 Registered Mail." Please provide the TYBR and TYAR estimate of the number of Registered Mail pieces representing internal use by the Postal Service.

RESPONSE:

Based on the volume forecast data for Registered Mail, the estimate for Postal Service use of Registered Mail would be 9,799,793 pieces for TYBR and 9,180,858 pieces for TYAR.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO INTERROGATORY OF THE OFFICE OF THE CONSUMER ADVOCATE**

OCA/USPS-T28-12. Please refer to USPS-LR-K-115, worksheet "SS-28 Registered Mail," and the number of Registered Mail transactions for FY 2004 of 5,008,595.

- a. Please confirm that the number of Registered Mail transactions (Domestic and Handling Charges) for FY2000 was 8,930,748. See Docket No. R2001-1, USPS-LR-J-110, worksheet "Registered Mail." If you do not confirm, please explain.
- b. Please identify and explain the factors causing the 44 percent (5,008,595 / 8,930,748 – 1) decline in Registered Mail transactions between FY 2000 and FY 2004.
- c. Please provide any economic, marketing or other research or documents addressing the decline in Registered Mail transactions.

RESPONSE:

- a. Confirmed.
- b-c. See USPS-T-8, at 205-209.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS TAUFIQUE TO INTERROGATORIES OF THE
OFFICE OF THE CONSUMER ADVOCATE REDIRECTED FROM WITNESS THRESS

OCA/USPS-T7-1. Please refer to USPS-LR-K-77, worksheet "A-2 Nonautomated Presort," and the line "NSA Adjustment." Please explain and show all calculations used to derive the NSA Adjustment of -\$116 for Nonautomated Presorted Letters, Flats and IPPs.

Response:

Please refer to my response to your interrogatory OCA/USPS-T28-2, which discussed the FY2004 (October 2003 to September 2004) data for Capital One. The attached Excel spreadsheet provides the FY 2004 volume data and the derivation of the NSA adjustments for the rate categories about which you have inquired.

Attachment to Response
to OCA/USPS-T7-1

CAPITAL ONE - OCTOBER 2003 TO SEPTEMBER 2004

Actual	1,293,384,779			
Threshold	1,225,000,000			
	68,384,779			
	1,275,000,000			
	1,225,000,001			
	49,999,999	\$ 0.030	\$	1,500,000
	1,293,384,779			
	1,275,000,001			
	18,384,778	\$ 0.035	\$	643,467
Total	68,384,777			2,143,467
Nonauto Presort Letters	69,950,056	5.4%	\$	115,925
Mixed AADC Letters	91,377,213	7.1%	\$	151,435
AADC Letters	93,753,920	7.2%	\$	155,374
3-Digit Letters	570,184,237	44.1%	\$	944,940
5-Digit Letters	396,187,666	30.6%	\$	656,584
Mixed ADC Flats	67,409	0.0%	\$	112
ADC Flats	30,302	0.0%	\$	50
3-Digit Flats	361,777	0.0%	\$	600
5-Digit Flats	5,521	0.0%	\$	9
Automation Carrier Route Letters	71,466,678	5.5%	\$	118,438
	1,293,384,779			2,143,467

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS TAUFIQUE TO INTERROGATORIES OF THE
OFFICE OF THE CONSUMER ADVOCATE REDIRECTED FROM WITNESS THRESS

OCA/USPS-T7-2. Please refer to USPS-LR-K-77, worksheet "A-3-pg 1 Auto Presort Letters," and the line "NSA Adjustment." Please explain and show all calculations used to derive the NSA Adjustment of -\$151, -\$155, -\$945, and -\$657 for Mixed AADC Automation, AADC Automation, 3-Digit Automation, and 5-digit Automation, respectively.

Response:

Please see my response to interrogatory OCA/USPS-T7-1.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS TAUFIQUE TO INTERROGATORIES OF THE
OFFICE OF THE CONSUMER ADVOCATE REDIRECTED FROM WITNESS THRESS

OCA/USPS-T7-3. Please refer to USPS-LR-K-77, worksheet "A-3-pg 2 Auto Presort Flats," and the line "NSA Adjustment." Please explain and show all calculations used to derive the NSA Adjustment of -\$1 for 3-Digit Automation flats.

Response:

Please see my response to interrogatory OCA/USPS-T7-1.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS TAUFIQUE TO INTERROGATORIES OF THE
OFFICE OF THE CONSUMER ADVOCATE REDIRECTED FROM WITNESS THRESS

OCA/USPS-T7-4. Please refer to USPS-LR-K-77, worksheet "A-4 Carrier Route Letters," and the line "NSA Adjustment." Please explain and show all calculations used to derive the NSA Adjustment of -\$118 for Automated Carrier Route Letters.

Response:

Please see my response to interrogatory OCA/USPS-T7-1.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS TAUFIQUE TO INTERROGATORIES OF THE
OFFICE OF THE CONSUMER ADVOCATE REDIRECTED FROM WITNESS THRESS

OCA/USPS-T7-5. Please refer to USPS-LR-K-77, worksheet "A-9 NSA Discounts," and the line "Pieces."

- a. Please explain and show all calculations used to derive the volume of NSA pieces of 68,385.
- b. Please confirm that during the base year (FY 2004), the only NSA in effect was the NSA with Capital One. If you do not confirm, please explain.
- c. Please confirm that Capital One's estimated annual volume on which discounts were paid in FY2004 was 63,862,895 ($69,184,803 / 13 \cdot 12$). See Docket No. MC2002-2, Data Collection Report, January 31, 2005, at Appendix A: page 1. If you do not confirm, please explain.

Response

- a. Please see my response to interrogatory OCA/USPS-T7-1.
- b. Confirmed.
- c. Not confirmed. Please see my responses to interrogatory OCA/USPS-T28-2(c) and interrogatory OCA/USPS-T7-1.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 1, PART B

Please refer to USPS-T-21 Tables 1 and 2, USPS LR-K-48 and LR-K-110. The workshare-related savings for (machinable) First-Class Mail Nonautomation Presort letters is *negative* 1.413 cents using the USPS proposed methodology and *negative* 1.652 cents using the methods in the R2001-1 PRC Opinion. These results imply that presorted First-Class letters that are not prebarcoded are more costly for the Postal Service to process than similar letters that are not presorted.

- a. Please provide any operational, methodological, data collection or other explanation for this result. Include a discussion of how changes in the entry profile of Nonautomation Presort letters since Docket No. R97-1 might affect the calculation of the workshare-related mail processing costs of machinable Nonautomation Presort letters.
- b. Please explain the rationale for preserving and increasing the rate incentive for mailers to perform work that increases Postal Service costs.

RESPONSE:

- a. Please see the response of witness Abdirahman (USPS-T-21).
- b. First of all, as noted in witness Abdirahman's response to part a of this POIR, methodological issues may exist that could explain the negative value for the calculation of the workshare-related savings, so the prices as proposed would not necessarily result in higher costs due to mailers performing work. In fact, there is reason to believe that value remains in the mailer sortation of items that are not presented in a manner that facilitates their processing through postal automation. In essence, the Postal Service may still be benefited by mailers presorting mail that does not readily go through postal automation, and thereby avoiding potentially relatively expensive processing costs as a result of the presorting.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 1, PART B

Response to POIR No. 1b continued

Moreover, this filing is designed to fairly and equitably distribute the escrow burden to the classes of mail, and within the mail classes to individual rate categories. The proposed prices are based on the application of a 5.4 percent target increase for each rate category, adhering to the rounding conventions for that particular rate category. In a traditional omnibus case we could potentially reexamine costing methodologies and the alignment of discounts, as well as consider potential classification changes. These issues will be reviewed prior to the filing of the next omnibus rate filing. In fact, we believe it is more appropriate to examine the entire array of discounts at that time.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

1. Please confirm the mail processing, delivery, and total workshare unit costs; discounts; and percentage passthroughs for First-Class Mail shown in Table 1. Provide corrections as appropriate. All costs reflect the Commission's methodology used in Docket No. R2001-1, as presented by the Postal Service in the current docket.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3

Revised: May 24, 2005

Table 1. First-Class Mail
Docket No. R2005-1
Worksharing Discounts
PRC Version (Amounts in Cents per Piece)

	Mail Processing Unit Cost (1)	Source for Mail Proc Unit Cost	Delivery Unit Cost (2)	Source for Delivery Unit Cost (4)	Total Workshare Unit Cost (3)=(1)+(2)	Discount v (4)	Percentage Passthrough (5)
1 Handwritten Reply Mail Cards / Letters	3.447	LRK-104, Sec. A, p.1, Col.3, G12	N/A		3.447		
2 CBRM Cards / Letters	1.249	LRK-104, Sec. A, p.1, Col.3, G13	N/A		1.249		
3 CBRM Cards / Letters Differential (L1 - L2)					2.198	3.2	146%
<u>Presort Letter Differentials</u>							
4 Bulk Metered Mail Letters	10.710	LRK-110, p.1, Col.2, F9	3.972	LRK-110, p.1, Col.3, H9	14.682		
5 Nonauto Presort Machinable Letters	12.459	LRK-110, p.1, Col.2, F19	3.875	LRK-110, p.1, Col.3, H19	16.334		
6 Nonauto Presort Mach. Letter Differential (L4 - L5)					(1.652)	1.9	-115%
7 Bulk Metered Mail Letters	10.710	LRK-110, p.1, Col.2, F9	3.972	LRK-110, p.1, Col.3, H9	14.682		
8 Auto Mixed AADC Letters	4.872	LRK-110, p.1, Col.2, F20	4.155	LRK-110, p.1, Col.3, H20	9.027		
9 Auto Mixed AADC Letters Differential (L7 - L8)					5.655	6.4	113%
10 Auto Mixed AADC Letters	4.872	LRK-110, p.1, Col.2, F20	4.155	LRK-110, p.1, Col.3, H20	9.027		
11 Auto AADC Letters	3.944	LRK-110, p.1, Col.2, F21	3.981	LRK-110, p.1, Col.3, H21	7.925		
12 Auto AADC Letters Differential (L10 - L11)					1.102	0.9	82%
13 Auto AADC Letters	3.944	LRK-110, p.1, Col.2, F21	3.981	LRK-110, p.1, Col.3, H21	7.925		
14 Auto 3-Digit Presort Letters	3.610	LRK-110, p.1, Col.2, F22	3.903	LRK-110, p.1, Col.3, H22	7.513		
15 Auto 3-Digit Presort Letters Differential (L13 - L14)					0.412	0.9	218%
16 Auto 3-Digit Presort Letters	3.610	LRK-110, p.1, Col.2, F22	3.903	LRK-110, p.1, Col.3, H22	7.513		
17 Auto 5-Digit Presort Letters	2.414	LRK-110, p.1, Col.2, F23	3.695	LRK-110, p.1, Col.3, H23	6.109		
18 Auto 5-Digit Presort Letters Differential (L16 - L17)					1.404	1.5	107%
19 Auto 5-Digit Presort Letters (CSBCS/Manual Sites)	2.759	LRK-110, p.1, Col.2, F24	6.280	LRK-110, p.1, Col.3, H24	9.039		
20 Auto Carrier Route Presort Letters	1.843	LRK-110, p.1, Col.2, F25	6.136	LRK-110, p.1, Col.3, H25	7.979		
21 Auto Carrier Route Presort Letters Differential (L119 - L20)					1.060	0.3	28%
<u>Automation Presort Flat Differentials</u>							
22 Auto Mixed ADC Presort Flats	30.109	LRK-102, p.1, Col.11, E36	8.978	LRK-101, Table 1, C26	39.087		
23 Auto ADC Presort Flats	22.241	LRK-102, p.1, Col.11, E38	8.978	LRK-101, Table 1, C26	31.219		
24 Auto ADC Presort Flats Differential (L22 - L23)					7.668	0.8	10%
25 Auto ADC Presort Flats	22.241	LRK-102, p.1, Col.11, E38	8.978	LRK-101, Table 1, C26	31.219		
26 Auto 3-Digit Presort Flats	19.898	LRK-102, p.1, Col.11, E40	8.978	LRK-101, Table 1, C26	28.876		
27 Auto 3-Digit Presort Flats Differential (L25 - L26)					2.343	1.2	51%
28 Auto 3-Digit Presort Flats	19.898	LRK-102, p.1, Col.11, E40	8.978	LRK-101, Table 1, C26	28.876		
29 Auto 5-Digit Presort Flats	8.375	LRK-102, p.1, Col.11, E42	8.978	LRK-101, Table 1, C26	17.353		
30 Auto 5-Digit Presort Flats Differential (L28 - L29)					11.523	2.1	18%
<u>Presort Cards Differentials</u>							
31 NonAuto Presort Cards	6.356	LRK-110, p.34, Col.2, D9	2.847	LRK-110, p.34, Col.3, F9	9.203		
32 Auto Mixed AADC Cards	2.863	LRK-110, p.34, Col.2, D10	2.981	LRK-110, p.34, Col.3, F10	5.844		
33 Auto Mixed AADC Cards Differential (L31 - L32)					3.359	1.9	57%
34 Auto Mixed AADC Cards	2.863	LRK-110, p.34, Col.2, D10	2.981	LRK-110, p.34, Col.3, F10	5.844		
35 Auto AADC Cards	2.314	LRK-110, p.34, Col.2, D11	2.853	LRK-110, p.34, Col.3, F11	5.167		
36 Auto AADC Cards Differential (L34 - L35)					0.677	0.7	103%
37 Auto AADC Cards	2.314	LRK-110, p.34, Col.2, D11	2.853	LRK-110, p.34, Col.3, F11	5.167		
38 Auto 3-Digit Presort Cards	2.116	LRK-110, p.34, Col.2, D12	2.796	LRK-110, p.34, Col.3, F12	4.912		
39 Auto 3-Digit Presort Cards Differential (L37 - L38)					0.255	0.4	157%
40 Auto 3-Digit Presort Cards	2.116	LRK-110, p.34, Col.2, D12	2.796	LRK-110, p.34, Col.3, F12	4.912		
41 Auto 5-Digit Presort Cards	1.429	LRK-110, p.34, Col.2, D13	2.644	LRK-110, p.34, Col.3, F13	4.073		
42 Auto 5-Digit Presort Cards Differential (L40 - L41)					0.839	0.7	83%
43 Auto 5-Digit Presort Cards (CSBCS/Manual Sites)	1.612	LRK-110, p.34, Col.2, D14	4.534	LRK-110, p.34, Col.3, F14	6.146		
44 Auto Carrier Route Presort Cards	1.070	LRK-110, p.34, Col.2, D15	4.430	LRK-110, p.34, Col.3, F15	5.500		
45 Auto Carrier Route Presort Cards Differential (L43 - L44)					0.646	0.7	108%

V Discounts calculated using the proposed rates shown in Exhibit USPS-28A, page 1 of 65.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

RESPONSE TO QUESTION 1:

The Postal Service in this particular case did not rely on cost avoidances to calculate the discount and subsequent rates for the various presort and automation categories. Rather, a target increase of 5.4 percent was uniformly applied to almost all rates. This caused the benchmark rates and the discounts to increase by the same percent, except for differences due to rounding constraints. Nevertheless, for the purpose of responding to this Presiding Officer's Information Request (POIR), I can verify the cost numbers used and the calculations performed, and offer some observations on how these calculations would fit into the overall rate design framework in a more traditional case.

Generally, the ratemaking process is not a mechanical process. Cost avoidances are analyzed, passthroughs are calculated, but proposed and recommended rates take into account the nine rate making criteria with a full assessment of the impact of rates on customers.

The arithmetic, i.e. the derivation of cost avoidances, discounts and the calculation of passthrough percents, is accurate. The underlying cost study that estimates the mail processing unit cost for letters is being revised (see LR-K-48 and LR-K-110). Errata will be filed very soon later, but I have replicated the arithmetic and produced a new version of Table 1 using the revised mail processing unit costs for letters.

The Postal Service calculates discounts and cost avoidances for workshared letters based on the First-Class Mail Single-Piece rate and the benchmark cost of Bulk Metered Mail Letters, respectively. I have calculated the

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 1(continued):

passthroughs using this Postal Service methodology in Table 1A. The Postal Service methodology and the methodology in the question would be identical if passthroughs of 100 percent were used at each step. But, if passthroughs differ from 100 percent, then the Postal Service methodology has an advantage of keeping the passthrough at each level independent of passthroughs at the previous levels. That is, the passthrough is calculated based on the full amount of worksharing performed between the benchmark and a given level of worksharing rather than only the incremental worksharing between discount levels. This is illustrated by the following simple example:

Rate Category	Cost Avoidance	Discount	Passthrough (Incremental)	Passthrough (Total)
Basic	4 cents	3 cents	$3 / 4 = 75 \%$	$3 / 4 = 75 \%$
3-Digit	6 cents	7 cents	$(7-3)/(6-4) = 200\%$	$7/6 = 117\%$
5-Digit	8 cents	8 cents	$(8-7)/(8-6) = 50\%$	$8/8 = 100\%$

I would like to provide some observations on the use of a similar methodology for calculating passthroughs for First-Class Mail flat shaped pieces and Cards. Neither the Postal Service nor the Postal Rate Commission has used the cost avoidances directly to calculate the rates for Automation presorted flats. The rates for flats have been proposed by the Postal Service and recommended by the Commission based on other rate relationships considerations.

For First-Class Mail Cards, there is no single-piece benchmark for the calculation of cost avoidances. The cost avoidances for automation cards are calculated as the incremental costs avoided from the nonautomation presort tier to the appropriate automation tier. The mail processing cost models for cards use

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3
Revised: May 24, 2005**

Response to Question 1(continued):

the letters cost model studies with appropriate ratios. In other words, there is no independent mail processing cost model for cards.

Table 1. First-Class Mail
Docket No. R2005-1
Worksharing Discounts
PRC Version (Amounts in Cents per Piece)

		Mail Processing Unit Cost	Source for Mail Proc Unit Cost	Delivery Unit Cost	Source for Delivery Unit Cost	Total Workshare Unit Cost (3)=(1)+(2)	Discount 1/ (4)	Percentage Passthrough (5)
		(1)		(2)		(3)=(1)+(2)	(4)	(5)
1	Handwritten Reply Mail Cards / Letters	3.447	LR-K-104, Sec. A, p.1, Col.3, G12	N/A		3.447		
2	QBRM Cards / Letters	1.249	LR-K-104, Sec. A, p.1, Col.3, G13	N/A		1.249		
3	QBRM Cards / Letters Differential (L.1 - L.2)					2.198	3.2	146%
Presort Letter Differentials								
4	Bulk Metered Mail Letters	11.231	LR-K-110, p.1, Col.2, F9	3.972	LR-K-110, p.1, Col.3, H9	15.203		
5	Nonauto Presort Machinable Letters	12.891	LR-K-110, p.1, Col.2, F19	3.875	LR-K-110, p.1, Col.3, H19	16.766		
6	Nonauto Presort Mach. Letter Differential (L.4 - L.5)					(1.563)	1.9	-122%
7	Bulk Metered Mail Letters	11.231	LR-K-110, p.1, Col.2, F9	3.972	LR-K-110, p.1, Col.3, H9	15.203		
8	Auto Mixed AADC Letters	4.917	LR-K-110, p.1, Col.2, F20	4.155	LR-K-110, p.1, Col.3, H20	9.072		
9	Auto Mixed AADC Letters Differential (L.7 - L.8)					6.131	6.4	104%
10	Auto Mixed AADC Letters	4.917	LR-K-110, p.1, Col.2, F20	4.155	LR-K-110, p.1, Col.3, H20	9.072		
11	Auto AADC Letters	3.992	LR-K-110, p.1, Col.2, F21	3.981	LR-K-110, p.1, Col.3, H21	7.973		
12	Auto AADC Letters Differential (L.10 - L.11)					1.099	0.9	82%
13	Auto AADC Letters	3.992	LR-K-110, p.1, Col.2, F21	3.981	LR-K-110, p.1, Col.3, H21	7.973		
14	Auto 3-Digit Presort Letters	3.659	LR-K-110, p.1, Col.2, F22	3.903	LR-K-110, p.1, Col.3, H22	7.562		
15	Auto 3-Digit Presort Letters Differential (L.13 - L.14)					0.411	0.9	219%
16	Auto 3-Digit Presort Letters	3.659	LR-K-110, p.1, Col.2, F22	3.903	LR-K-110, p.1, Col.3, H22	7.562		
17	Auto 5-Digit Presort Letters	2.542	LR-K-110, p.1, Col.2, F23	3.695	LR-K-110, p.1, Col.3, H23	6.237		
18	Auto 5-Digit Presort Letters Differential (L.16 - L.17)					1.325	1.5	113%
19	Auto 5-Digit Presort Letters (CSBCS/Manual Sites)	2.811	LR-K-110, p.1, Col.2, F24	6.280	LR-K-110, p.1, Col.3, H24	9.091		
20	Auto Carrier Route Presort Letters	1.898	LR-K-110, p.1, Col.2, F25	6.136	LR-K-110, p.1, Col.3, H25	8.034		
21	Auto Carrier Route Presort Letters Differential (L.119 - L.20)					1.057	0.3	28%
Automation Presort Flat Differentials								
22	Auto Mixed ADC Presort Flats	30.109	LR-K-102, p.1, Col.11, E36	8.978	LR-K-101, Table 1, C26	39.087		
23	Auto ADC Presort Flats	22.241	LR-K-102, p.1, Col.11, E38	8.978	LR-K-101, Table 1, C26	31.219		
24	Auto ADC Presort Flats Differential (L.22 - L.23)					7.868	0.8	10%
25	Auto ADC Presort Flats	22.241	LR-K-102, p.1, Col.11, E38	8.978	LR-K-101, Table 1, C26	31.219		
26	Auto 3-Digit Presort Flats	19.898	LR-K-102, p.1, Col.11, E40	8.978	LR-K-101, Table 1, C26	28.876		
27	Auto 3-Digit Presort Flats Differential (L.25 - L.26)					2.343	1.2	51%
28	Auto 3-Digit Presort Flats	19.898	LR-K-102, p.1, Col.11, E40	8.978	LR-K-101, Table 1, C26	28.876		
29	Auto 5-Digit Presort Flats	8.375	LR-K-102, p.1, Col.11, E42	8.978	LR-K-101, Table 1, C26	17.353		
30	Auto 5-Digit Presort Flats Differential (L.28 - L.29)					11.523	2.1	18%
Presort Cards Differentials								
31	NonAuto Presort Cards	6.496	LR-K-110, p.34, Col.2, D9	2.847	LR-K-110, p.34, Col.3, F9	9.343		
32	Auto Mixed AADC Cards	2.896	LR-K-110, p.34, Col.2, D10	2.981	LR-K-110, p.34, Col.3, F10	5.877		
33	Auto Mixed AADC Cards Differential (L.31 - L.32)					3.466	1.9	55%
34	Auto Mixed AADC Cards	2.896	LR-K-110, p.34, Col.2, D10	2.981	LR-K-110, p.34, Col.3, F10	5.877		
35	Auto AADC Cards	2.347	LR-K-110, p.34, Col.2, D11	2.853	LR-K-110, p.34, Col.3, F11	5.200		
36	Auto AADC Cards Differential (L.34 - L.35)					0.677	0.7	103%
37	Auto AADC Cards	2.347	LR-K-110, p.34, Col.2, D11	2.853	LR-K-110, p.34, Col.3, F11	5.200		
38	Auto 3-Digit Presort Cards	2.149	LR-K-110, p.34, Col.2, D12	2.796	LR-K-110, p.34, Col.3, F12	4.945		
39	Auto 3-Digit Presort Cards Differential (L.37 - L.38)					0.255	0.4	157%
40	Auto 3-Digit Presort Cards	2.149	LR-K-110, p.34, Col.2, D12	2.796	LR-K-110, p.34, Col.3, F12	4.945		
41	Auto 5-Digit Presort Cards	1.456	LR-K-110, p.34, Col.2, D13	2.644	LR-K-110, p.34, Col.3, F13	4.100		
42	Auto 5-Digit Presort Cards Differential (L.40 - L.41)					0.845	0.7	83%
43	Auto 5-Digit Presort Cards (CSBCS/Manual Sites)	1.646	LR-K-110, p.34, Col.2, D14	4.534	LR-K-110, p.34, Col.3, F14	6.180		
44	Auto Carrier Route Presort Cards	1.105	LR-K-110, p.34, Col.2, D15	4.430	LR-K-110, p.34, Col.3, F15	5.535		
45	Auto Carrier Route Presort Cards Differential (L.43 - L.44)					0.645	0.7	109%

1/ Discounts calculated using the proposed rates shown in Exhibit USPS-28A, page 1 of 65.

Table 1A
Attachment POIR3 Question1

Table 1A. Passthroughs Calculated Using the Postal Service Methodology

	Nonautomation			3-Digit Automation Letters	5-Digit Automation Letters
	Presort	Mixed AADC	AADC		
Single Piece	0.390	0.390	0.390	0.390	0.390
Discounted Rate	0.371	0.326	0.317	0.308	0.293
Discount	0.019	0.064	0.073	0.082	0.097
Benchmark	15.203	15.203	15.203	15.203	15.203
Workshare Unit Cost	16.766	9.072	7.973	7.562	6.237
Differential	-1.563	6.131	7.230	7.641	8.966
Percentage Passthrough	-122%	104%	101%	107%	108%
	Carrier Route Automation Letters				
	Carrier Route				
5-Digit	0.293				
Discounted Rate	0.29				
Discount	0.003				
Benchmark (5-Digit Manual)	9.091				
Carrier Route	8.034				
Differential	1.056				
Percentage Passthrough	28%				

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 7**

Question 7 (continued):

disadvantage of presenting passthrough percentages that can potentially conceal inefficient price signals of the type demonstrated in Table 2 above.

- b. Please discuss the relative merits for each First-Class Mail automation presort category of using bulk metered mail as the benchmark versus using the next-least presorted category as the benchmark. For example, which is the mail more likely to convert to automation 5-digit presort letters: bulk metered mail or automation 3-digit presort letters? Include a discussion of the choices mailers may make with respect to preparing (and sorting) mailings in-house or using the services of a third-party mail consolidator to achieve a greater depth-of-sort.

RESPONSE:

- a. As I stated in my response to question 1 of POIR 3, both methods of calculating passthroughs would be equivalent if the incremental method utilizes a 100 passthrough at each level. The arithmetic in both tables appears to be accurate. However, I would like to make a few observations about the example in Table 2. First, neither the Postal Service nor the Commission has information on the mailers' cost of preparing the mail. This information is not and should not be relevant to establishing workshare discounts. What matters is that mailers are provided appropriate signals based on the workshare savings accruing to the Postal Service (because more highly prepared mail is entered) and the policy considerations of the Act. Second, calculating lowest combined costs, as in the example in Table 2, requires estimates of the mailer's costs of preparing workshared mail. Changing these estimates may lead to results where the discount for workshare level C produces the lowest combined cost for the whole society. If an assumption is made that the mailer's cost

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 7**

Response to Question 7 (continued):

for Rate Category B is 5.5 units and for Rate Category C is 6 units, then Rate Category C would provide the lowest combined cost to the society. Since mailer costs are not known, realistically it is impossible to incorporate estimates of these costs into calculations of postal workshare discounts.

More fundamentally, this question attempts to rigidly apply Efficient Component Pricing (ECP) rules without considering the context in which the pricing decision is made. While the Postal Service believes that ECP generally provides for the optimum allocation of resources for society, the pricing criteria also call for evaluating other factors that may result in results that are not completely consistent with any single pricing theory. Rate design must consider the totality of all factors at a given time, a fact that the Commission has often recognized in its rate design. The Commission and the Postal Service have the responsibility of objectively evaluating these "efficient pricing theories" in light of all the other factors enumerated in the pricing criteria.

The Postal Service methodology of calculating the total passthrough by comparing the total cost avoidance to the total discount (using an undiscounted rate as a benchmark) results in each level of worksharing being judged as efficient or inefficient independently. As a result, the determination as to whether a rate is an efficient price signal is not affected by a judgment that was made for another level of

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 7**

Response to Question 7 (continued):

worksharing. In the instant proceeding, the incremental passthrough for the 3-Digit presort level is 219 percent due to the choice of passthroughs at previous levels. The passthrough (using the incremental approach) for the 3-Digit presort level of 219 percent can be reduced to 100 percent by cutting the discount and raising the 3-Digit rate by approximately one-half cent. This change would then increase the passthrough for the 5-Digit rate to 150 percent. A hike of approximately 0.7 cents would be needed in the 5-Digit rate to make the passthrough for this level 100 percent. The already high cost coverage for the workshare mail would increase further, and the 3-Digit and 5-Digit rates would increase by 7.2 and 7.9 percents, respectively, instead of the target 5.4 percent. Therefore, while the signals using incremental passthroughs become efficient, another signal (the value of the total amount of worksharing) is inefficient.

The total passthrough approach implicitly recognizes that customers (either on their own behalf or through service bureaus) may not "step up" through individual levels of worksharing (sorting to mixed-AADC, then deciding to sort further to AADC, then to 3-digit, and finally to 5-digit), but rather may make a "yes or no" decision to workshare or not and, once this decision is made, attempt to reach the highest level of sortation possible. In fact, the Postal Service's regulations require a 3-digit sortation, with the intent that as many pieces will be presorted to at least this level, given the available volume and density. Anecdotal examples of

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 7**

Response to Question 7 (continued):

both types of decisions – supporting both approaches to passthroughs -- can probably be found. Similarly, examples can be constructed that could be used to portray either approach to passthroughs as sending contradictory “efficient” or “inefficient” pricing signals.

Ratemaking is as much of an art as it is science, and for a variety of policy reasons (mitigating the effect of a rate change or gradually moving towards a desired rate objective), an individual passthrough (measured on either an incremental or a total basis) may differ from 100 percent. The entire context of the rate proposal must be considered, before a rate decision is made. For First-Class Mail, the Postal Service generally has presented passthroughs calculated on a “total” basis reflecting the evaluation of whether a price as a whole is efficient or inefficient, but we do not ignore the incremental signals sent, and we generally do review the potential effects of “incremental” passthroughs and the resulting pricing signals. While we believe the total passthrough approach is the primary tool for evaluating discounts, we do not rule out using incremental cost avoidances as an additional check to see how incremental discounts line up with cost avoidances. Differences between intermediate discounts and cost avoidances should be reviewed, and the rationale for those differences understood.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 7**

Response to Question 7 (continued):

Applying any pricing rule (including the choice of how to present passthroughs) as a rigid pricing determinant is inconsistent with the application of the statutory pricing criteria as well as simple common sense. Generally, we believe the incremental approach to workshare discounts could too rigidly limit the discount decisions made by the Postal Rate Commission and the Postal Service. As long as the process of ratemaking provides correct signals to mailers based on the Postal Service's cost structure, in conjunction with other relevant policy determinations, then this goal should be achieved.

- b. It is truly difficult to generalize and make a categorical statement regarding the conversion of mail to a specific higher level, be it 3-Digit or AADC. The decisions of individual mailers are based on their own operations, whether they prepare their mail or whether they choose to use third-party service providers to prepare mail. In some cases, customers' mail preparation may be very similar to how the Postal Service would process the mail; in other cases there may be substantial differences. For example, my understanding is that some large mailers are able to electronically presort their lists prior to creating their mail, while others physically presort the mail much in the same way as the Postal Service would. Similarly, other customers present unsorted mail to presort businesses which combine their mail with mail from other customers to

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 7**

Response to Question 7 (continued):

gain finer presort and to upgrade the mail by applying barcodes.

Regardless of the method used, mailers do not move through the levels of sortation in a step function, i.e. first electing to presort to only to the mixed-AADC level, then moving up to the AADC-level, and so on. As noted previously, the Postal Service's regulations require a 3-digit sortation, with the intent that as many pieces will be presorted to at least this level, given the available volume and density. In addition, it appears that the business strategy for some large presort bureaus is the conversion of single-piece mail or other less workshared mail to 5-Digit workshared mail, if at all possible.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-1. Please refer to library reference USPS-LR-K-115, file USPST28Aspreadsheets.xls. The sheet "ECR-15 Rate Adjustments" shows 15 special adjustments to ECR commercial rates, all of them positive. You indicate that these adjustments are "to remove irregularities in rate differentials caused by rounding."

- a. Referencing the statistical expectation that normal rounding procedures involve both rounding up and sometimes down, please explain how it is that all 15 of the adjustments have a positive effect on the rates.
- b. For each of the 15 adjustments, individually, please identify and specify the "irregularity" that you saw in the rates, which caused you to make the adjustment, and explain how your adjustment fixed the anomaly.

Response:

a&b. Since neither the rate anomalies nor the remedy for the anomalies were the result of a statistically random process, there should be no a priori expectation that the adjustments would not have all the same sign.

The adjustments were made to ensure that current consistency in discounting practices was maintained. For instance, the DSCF discount would be the same (0.5 cents off the DBMC rates) for all shapes and presort levels, and similarly, Origin-DBMC and DSCF-DDU discounts were kept uniform across shape and presort levels. For Saturation parcels (piece rated pieces) and Basic parcels (pound rated pieces), the adjustments were designed to ensure that the RSS was uniform for all presort levels.

These anomalies can be seen by comparing the unadjusted drop-ship rate differentials (and RSS values for parcels) across shape and presort levels. That the adjustments fixed the anomalies can be seen by making the same comparisons using the adjusted ECR rates.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-2. Please refer to your testimony, USPS-T-28, page 11 (ll. 17-18), where you say that, under the Postal Service proposal, Standard Mail ECR receives a rate increase of 5.6 percent, while Standard Mail Nonprofit ECR receives a rate increase of 5.9 percent. Please refer also to your statement on page 11 (ll. 21-26) that Public Law 106-384 requires the per-piece revenue of Nonprofit to be equal as nearly as practical to 60 percent of the per-piece revenue of the corresponding commercial category, and that your proportion is 56 percent. On page 12 (ll. 2-4 and ll. 9-12) you say that honoring the 60-percent proportion stipulated in Public Law 106-384 would require a rate increase for Nonprofit "on the order of 13 percent," and that, "under the unique circumstances of this uniform across-the-board rate increase request," your 56 percent is as close to 60 percent as is practical.

- a. Within the framework of an across-the-board preference of 5.4 percent and an increase of 5.6 percent for commercial ECR, please explain how the issue of practicality led you to lower the rate increase for Nonprofit ECR from 13 percent to 5.9 percent.
- b. Aside from a stated preference by Postal Service witness Potter (USPS-T-1), as explained in his testimony, please identify and discuss the circumstances in this case that caused you to give (i) little weight to the requirement imposed by law (as witnessed by your 5.9 percent increase being considerably below the 13 percent mandated by the statute), and (ii) substantial weight to the preference of a 5.4 percent increase (as witnessed to by 5.9 percent being just moderately above 5.4 percent).
- c. On page 29 (ll. 8-9) of your testimony, you say that the "average proposed fee increase for registered mail is in the range of 70 percent, in order to cover costs." As applied to your work and the rates which you recommend, please explain your understanding of the difference between (i) the legal requirement that rates cover costs, which causes you to raise the rate increase for registered mail from 5.4 percent up to 70 percent, and (ii) the legal requirement that the per-piece revenue of Nonprofit ECR be 60 percent of the corresponding figure for the commercial category, which causes you to take the rate increase for Nonprofit ECR from 5.4 percent up to 5.9 percent, but not up to 13 percent.
- d. Public Law 103-123 (Revenue Forgone Reform Act of 1993) requires that Within County Periodicals have a markup that is one-half the markup of the corresponding commercial category of Periodicals. Because of this, as explained on page 14 of your testimony, you propose a rate **decrease** for Within County of 5.4 percent. As applied to your work, please explain your understanding of the difference between (i) the legal requirement in Public Law 103-123 relating to the markup on Within County, which causes you to take the rate increase for Within County from a positive 5.4 percent down to a negative 5.4 percent, a spread of 10.8 percentage points, and (ii) the legal requirement in Public Law 106-384 that the per-piece revenue of Nonprofit ECR be 60 percent of the corresponding figure for the commercial category, which causes you to take the rate increase

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

for Nonprofit ECR from 5.4 percent up to 5.9 percent, but not up to 13 percent, the latter being a spread of 7.6 percentage points.

- e. In your opinion, does an average nonprofit per-piece revenue equal to 56 percent of the corresponding category complies with Public Law 106-384? If not, please explain your recommendation.
- f. Is it your interpretation of Public Law 106-384 that nonprofit per-piece revenue may be measurably less than 60 percent of the corresponding commercial category, but not measurably more than 60 percent of it? If not, please explain.
- g. Are you advocating that the Postal Rate Commission recommend an average nonprofit per-piece revenue equal to only 56 percent of the corresponding category, regardless of whether it complies with Public Law 106-384? If not, please explain.
- h. (i) Please confirm that one lawful way to satisfy a guideline pointing to increases of 5.4 percent and to satisfy as well the legal requirement on the perpiece revenue of Nonprofit would be to specify an increase for Nonprofit ECR of 5.4 percent and to reduce the rate increase for commercial ECR so that the 60-percent law is satisfied. This approach would avoid taking the preferred category of Nonprofit ECR, which has always received special rate consideration, above the 5.4 percent guideline. (ii) Please explain why this approach is inferior to the approach you have taken. (iii) If you do not believe it to be lawful, please explain why you did not take such an approach.
- i. Please assume that in **this** case the Nonprofit ECR increase were 7.4 percentage points above the increase for commercial ECR, but you held it to a difference of 0.3 percentage points, and in the **next** rate case the Nonprofit ECR increase were 14.8 percentage points above the corresponding increase for commercial ECR. Please explain whether in the next rate case you believe that the effect on mailers would be too large, the law should be neglected, and a smaller increase (with an attendant loss of revenue to the Postal Service) should be adopted.

Response:

- a. As can be seen in the workpapers, a targeted uniform 5.4% increase was applied to both commercial and nonprofit ECR rates. The resulting 5.9% increase in the average revenue per piece for NECR is therefore the result of applying the uniform rate change policy, along with adhering to rounding constraints and maintaining discounting consistency, as described in my response to question 1, to both ECR and NECR rates, and not an after-the-fact decision to lower the NECR increase from 13% to 5.9%.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

- b. I disagree with the assertion that little weight was paid to the pricing requirement for Standard Mail NECR contained in PL 106-384. That law requires the prices to be set so that the average revenue per piece for nonprofit mail is "as nearly as practicable" to 60 percent of the average revenue per piece for commercial mail. The statute does not specify an absolute tolerance around the 60 percent figure that must be achieved. Rather, it specifies that the target be achieved within "practicable" bounds. The Postal Service interprets this language to permit deviation from the 60 percent target when the total circumstances of the case make it not practicable to achieve the 60 percent target more closely. Therefore I disagree with the assertion implicit in the question that a 13 percent increase is "mandated by the statute." The policy reasons stated in witness Potter's testimony (USPS -T-1) were the basis for the Postal Service's judgment that a higher rate increase for Standard Mail NECR was not practicable in this case.
- c. Please see my response to VP/USPS-T28-2b. The statutory requirement to cover costs is, in the view of the Postal Service, a more specific standard than the standard applied to Standard Mail Nonprofit and Standard Mail NECR rates.
- d. Please see my response to VP/USPS-T28-2b. The statutory requirement for pricing Within-County Periodicals is, in the view of the Postal Service, a more specific standard than the standard applied to Standard Mail Nonprofit and Standard Mail NECR rates.
- e. I believe that the proposed rates meet the requirements of the statute for the reasons set forth in my response to VP/USPS-T28-2b. The bands around the statute's 60 percent target that it is practicable to reach will depend on the

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

circumstances of the particular case. In another case, a closer approach than 56 percent may be practicable, and therefore required, by the statute.

- f. The deviation from 60 percent permitted by the practicability standard can be either above or below the 60 percent target.
- g. No. In this case, the proposed rates comply with PL 106-384. See my response to VP/USPS-T28-2b.
- h.
 - (i) I am advised that this approach would be lawful.
 - (ii) This approach would, *ceteris paribus*, leave the Postal Service far short of its revenue requirement.
 - (iii) See my response to part (i).
- i. In the next omnibus rate case the Postal Service will attempt to meet the 60 percent target, again, as nearly as practicable. The Postal Service always takes into account the effect of its proposed changes on mailers when setting rates, and will do so in the next rate case as well. Without more complete and detailed information regarding the conditions that would hold at the time the next rate case is filed, and until such time that I am charged with the responsibility of formally proposing rates in the next rate case, commenting on specific rate change values would be speculative and unwise.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-3. Please refer to Exhibit USPS-28A, page 16, Table 5, where you propose a "Presorted Basic" rate of \$0.282 for Standard Regular letters and a "Presorted Basic" rate of \$0.363 for Standard Regular non-letters, which is a letter/non-letter differential of 8.1 cents. This interrogatory relates to the justification for the corresponding letter/non-letter differential in the current rates of 7.6 cents, which is increased to the 8.1-cent figure by application of an across-the-board proportion.

- a. Please confirm that the 7.6-cent difference in current rates is developed, after rounding, by applying a 73 percent passthrough to a cost difference of 10.366 cents, as shown in cells E18 through G18 on the "PRE DIS" sheet of file USPSLR-J-WP1.xls in library reference USPS-LR-J-132 of Docket No. R2001-1. If you do not confirm without reservation, please explain the origin and development of the 7.6-cent letter/flat rate differential in current rates, and also explain the use made of the cells referenced herein.
- b. Please confirm that the cost differential of 10.366 cents, discussed in preceding part a, is the difference between a unit cost for Basic presort flats of 28.041 cents (equal to the sum of 8.312 cents for delivery and 19.729 cents for mail processing) and a unit cost for Basic presort letters of 17.675 cents (equal to the sum of 4.201 cents for delivery and 13.474 cents for mail processing), as shown on the "COST" sheet in the file and library reference cited in preceding part a. If you do not confirm without reservation, please explain the origin, development and components of the 10.366-cent cost differential.

Response:

- a. I did not prepare the workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. I can confirm that the 7.6 cent difference was developed as described in the first sentence of the question.
- b. I did not prepare the workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. I can confirm that the 10.366 cent cost differential was developed as described in the first sentence of the question.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-6. Regarding the 4.003-cent non-worksharing unit cost of processing Standard Regular Basic presort flats in VP/USPS-T28-5, part b:

- a. Please describe the nature of what that cost measures.
- b. Please explain why the 4.003-cent cost is not related to worksharing.
- c. Assume that the rate for basic, non-prebarcoded, minimum-per-piece flats, which is currently 34.4 cents, were to be reduced and resulted in a volume increase in line with the appropriate elasticity. Please state whether you would expect the cost of each additional unit of volume to reflect any part of this 4.003 cents, and explain why you come to the conclusion you do.
- d. Please explain whether the 4.003-cent cost figure is designed to be a marginal cost. If it is not, please explain the nature of the costing concept which it embodies.
- e. Please explain what worksharing the 4.003-cent figure is not sensitive to, describing the specific nature of the work that may (or may not) be shared.
- f. Please explain the extent to which you view it as important whether any worksharing-type work that you identify is provided by the lowest-cost provider.
- g. Please explain whether mailing a flat, as opposed to an identically prepared and entered letter, causes the Postal Service to do work that could have been done by the mailer.

Response:

- a. Redirected to witness Miller, USPS-T-19
- b. Redirected to witness Miller, USPS-T-19.
- c. Redirected to witness Miller, USPS-T-19.
- d. Redirected to witness Miller, USPS-T-19.
- e. Redirected to witness Miller, USPS-T-19.
- f. Generally speaking and putting aside the extraordinary circumstances of the current case, it is important for the Postal Service to provide accurate and consistent signals to the mailers regarding worksharing. The accuracy of these signals is based on the cost savings that accrue to the Postal Service when the work in question is performed by the mailers. Examples of such worksharing are finer presorting, barcoding or dropshipping of mail. Who actually performs the

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

work is not relevant to this exercise. Mailers can do the work themselves or contract it out to a third party, based on their analysis of their own cost structure and that of their contractors. One would expect that this worksharing will be provided by a low-cost provider but, from the perspective of the Postal Service, what is important is that mailers are provided the appropriate signals based on the Postal Service's cost savings.

- g. Redirected to witness Miller, USPS-T-19.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-7.

- a. For the 15.726-cent worksharing-related unit cost referenced in VP/USPS-T28-5, part a, please confirm that, according to library reference USPS-LR-J-61 in Docket No. 2001-1, it is equal to a model unit cost of 15.329 cents times a Cost and Revenue Analysis ("CRA") adjustment factor of 1.023 plus a worksharing related fixed cost of 0.047 cents. If you do not confirm, please provide the appropriate figure and give the source.
- b. For the model unit cost of 15.329 cents referenced in preceding part a, please provide a narrative description of the nature of this cost and answer the following questions.
 - i. Is this 15.726-cent worksharing-related unit cost an estimate of a marginal cost? If not, please explain the costing concept that guides this estimate.
 - ii. Is this 15.726-cent worksharing-related unit cost constrained or limited in any way? If yes, please explain each constraint and the reason for it.
 - iii. If the associated rate for basic, non-prebarcoded, minimum-per-piece flats, which is now 34.4 cents, were to be reduced and the volume were to increase in line with the elasticity, please explain whether you would expect the 15.726-cent figure to increase on a per-additional-unit basis.
 - iv. Is this 15.726-cent worksharing-related unit cost specifically designed or estimated to relate to any particular concept of worksharing? If so, please specify the piece of work that may or may not be shared.
 - v. If this cost is related to any concept of worksharing, please describe the nature of the signal in the rates that determines whether the piece of work involved is or is not done by the lowest-cost provider.

Response:

- a. Redirected to witness Miller, USPS-T-19.
- b. Except b. v, Redirected to witness Miller, USPS-T-19.
- v. Please see my response to your interrogatory VP/USPS-T28-6 subpart f.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-8. Please refer to VP/USPS-T28-3, part b. For the 4.201-cent unit cost for delivery of Standard Regular Basic presort letters referenced therein, please provide a narrative description of its nature. In your response, please include answers to the following questions.

- a. Is it in effect a bottom-up cost for delivery, or have adjustments been made? If the latter, please provide a description of all adjustments.
- b. Is this cost the same for nonprofit as for the commercial category? If so, does it therefore recognize no differences in cost incurrence between these two categories?
- c. Does it include both in-office costs and street costs?
- d. Is it designed to be a marginal cost? If not, please explain the theory that guides its development.
- e. Does it recognize both city routes and rural routes? How are these different?
- f. Why is this cost contained under the heading, "Alternative Costs for Specific Rate Design Purposes"? In your response, please state clearly what these purposes are and what effect these purposes had on the cost.
- g. Please confirm that the updated figure for this cost is 4.591 cents, 9.3 percent higher than the current figure, found in file LR-K-101STDLTRS.xls of library reference USPS-LR-K-101. If you do not confirm, please provide the correct updated figure and identify its source.

Response:

a to g except f redirected to witness Abdirahman, USPS-T-21.

- f. I did not prepare the workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. The following represents my understanding of this section of the workpapers. The costs shown in the section of the workpaper entitled "Alternative Costs for Specific Rate Design Purposes" represent average mail processing and delivery costs for the specific mail categories shown in the section. The cost item referenced in this interrogatory, 4.201 cents, represents the average delivery cost for a Basic Presort letter. It is included in this section to calculate the average mail processing plus delivery costs for the purposes of calculating the letter-flat cost differential. The mail

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

processing costs for Basic Presort letters in this section of the workpaper (though not the delivery costs) differ from the corresponding costs for Basic Presort letters shown above this section of the workpaper due to different mail mix assumptions. In other words, to calculate a true letter-flat differential it is necessary to adjust the presort mix of letters within the Basic Letters category to match the average mix for flats. Otherwise the cost differential would reflect not only the letter-flat differential, but also the difference in presort between the averages for flats and for letters.

RESPONSE OF UNITED STATES POSTAL SERVICE
 WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
 OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
 VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-9.

- a. Please refer to VP/USPS-T28-3, part b. For the 13.474-cent unit cost for mail processing of Standard Regular Basic presort letters referenced therein, please confirm that the source of this unit cost is cell C13 of the "LETTERS SUMMARY" sheet in file STANDARD.XLS file of library reference USPSLR-J-60 in Docket No. 2001-1, and that it is a weighted average of the more disaggregated unit costs in cells C14 through C17. If you do not confirm, please provide the appropriate updated figure and give the source.
- b. On the "COST" sheet in file USPS-LR-J-132-WP1.xls of library reference USPS-LR-J-132 in Docket No. 2001-1, cell F28, please explain why this 13.474-cent cost for mail processing of Standard Regular Basic presort letters is contained under the heading, "Alternative Costs for Specific Rate Design Purposes." Please provide an explicit statement concerning what such rate change purposes are and what effect these purposes had on the cost.
- c. Please provide a narrative description of the nature of this mail processing cost of 13.474 cent referenced in preceding parts a and b.
- d. Is this 13.474-cent unit cost an estimate of a marginal cost? If not, please explain the costing concept it measures.
- e. Is this 13.474-cent unit cost constrained or limited in any way? If yes, please explain each constraint and the reason for it.
- f. If the rate for Standard Regular Basic non-prebarcoded presort letters, which is now 26.8 cents, were to be reduced and there were to be an associated volume increase, in line with the appropriate elasticity, please explain whether you would expect the costs behind the 13.474-cent figure to increase on a peradditional-unit basis.
- g. Is this 13.474-cent cost specifically designed or estimated to relate to any particular concept of worksharing? If so, please specify the piece of work that may or may not be shared.
- h. If this 13.474-cent cost is related to any concept of worksharing, please describe the nature of the signal in the rates that determines whether the piece of work involved is or is not done by the lowest-cost provider.
- i. Please confirm that the updated unit cost for Standard Regular Basic presort letters is 17.303 cents, 28.4 percent higher than the level in Docket No. 2001-1, found the file LR-K-110.xls of library reference USPS-LR-K-110. If you do not confirm, please provide the correct figure and its source.

Response:

Subparts a, c-e, f & i redirected to witness Abdirahman, USPS-T21.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

- b. I did not prepare the workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. Please see my response to VP/USPS-T28-8f.
- g. I did not prepare the workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. If the question is meant to elicit whether the 13.474-cent figure represents the difference in cost between a workshared piece of mail and a non-workshared piece of mail, the answer is no. Please see my response to VP/USPS-T28-8f.
- h. Please see my response to VP/USPS-T28-9g.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Page 1 of 3

VP/USPS-T28-10.

- a. Please refer to Docket No. R2000-1, library reference PRC-LR-15, file WP1-PRC-Hybrid.xls, sheet "RATE DESIGN SHEET," cell DK25, which shows a passthrough of 73 percent for the letter/flat differential, and please explain the extent to which this Commission-recommended passthrough was the basis for the 73 percent passthrough proposed in Docket No. R2001-1 by the Postal Service, referenced in VP/USPS-T28-3, part a.
- b. Please refer to Docket No. R2000-1, *Opinion and Recommended Decision*, page 339, ¶ 5382, where the Commission says, "with respect to the letter/nonletter differential, the Commission believes it is appropriate to recognize more of the reported cost difference, where this can be achieved without undue impact." Please explain the extent to which the Postal Service's proposal to pass through only 73 percent of the letter/nonletter differential in Docket No. R2001-1 was responsive to the Commission's opinion that "it is appropriate to recognize more of the reported cost difference."
- c. Please explain whether it is the Postal Service's position that it is fair, equitable and appropriate to continue the passthrough of 73 percent by virtue of the across-the-board nature of the proposal in this case, losing this opportunity to take a step in a direction that the Commission has explained is "appropriate."
- d. Please explain whether the letter/nonletter cost differential is related to worksharing (*i.e.*, is related to a piece of work which could be done by either the Postal Service or the mailer). If so, please identify the specific type of worksharing.
- e. Please explain whether it is the Postal Service's position that the passthrough of the letter/nonletter cost differential into rates should be limited to 100 percent. If so, please explain the basis for this limit, drawing where appropriate on notions of fairness, lowest combined cost, and efficient component pricing.
- f. Please refer to Docket No. R90-1, where the letter/flat rate differential was first recommended (Op. & Rec. Dec., p. V-230, ¶ 5941). The Commission referred to establishing a new discount, "especially one based primarily on physical characteristics of the mail and not on traditional worksharing concepts." Please explain the Postal Service's position concerning the extent to which letters and flats should be viewed essentially as separate products, in separate but related markets, with cross elasticities similar to those for other separate-but-related products, and with costs and production facilities that are essentially separate or at least different in character.

Response:

- a. I did not prepare the workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. I have examined the relevant portion of the testimony of witness Moeller (USPS-T-32), who sponsored the

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Page 2 of 3

workpapers from Docket No. R2001-1 cited in the question. Based on the materials I have examined, I can confirm that in both instances the passthrough was 73 percent. These documents do not describe the extent to which the recommended passthrough in Docket No. R2000-1 was the basis for the proposed passthrough in Docket No. R2001-1.

- b. In proposing a passthrough percentage, many factors are taken into account. The opinion expressed by the Commission in the prior rate case is given serious consideration and weight in developing the Postal Service's proposal. In giving the Commission's opinion its due weight, the opinion is interpreted within the context of factors that existed when the opinion was given, rather than as an absolute directive, binding under all circumstances. In general, the Postal Service attempts to respond to the Commission's opinions in light of the totality of conditions and circumstances that are present at the time the Postal Service makes its decisions. I was not involved, either directly or indirectly, in developing the specified passthrough percentage in Docket No. R2001-1 and I do not know all of the factors, circumstances and considerations that went into the selection of the proposed passthrough percentage (see my response to VP/USPS-T28-10a). Therefore I am unable to characterize the degree to which the proposal in Docket No. R2001-1 responded to the Commission's opinion in Docket No. R2000-1.
- c. Yes, but I would disagree with the characterization of this rate request as a lost opportunity. Witness Potter (USPS-T-1) has stated that, absent the statutory escrow requirement, the Postal Service would not have filed any general rate case at this time. The Postal Service intends to consider necessary and

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Page 3 of 3

appropriate changes in classification and rate relationships when it files its next omnibus case.

- d. The cost differential is intended to reflect the mail processing cost differences between letters and flats, rather than worksharing as the term is normally understood.
- e. If the question refers to an absolute limit that cannot be breached in either direction, regardless of circumstances, the answer is no.
- f. The Postal Service views letters and flats as different shapes, and supports different rate treatment when appropriate, based on identifiable mail processing and delivery cost differences and other relevant factors. The Postal Service has not taken the position that letters and flats should necessarily be viewed as different products, since they often share close, if not identical, market characteristics, despite the fact that they may be treated for mail processing purposes as separate mail streams.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-11. Please refer to Docket No. R2000-1, *Opinion and Recommended Decision*, page 390, ¶ 5533, where the Commission states:

The Commission begins the rate design process assuming equal implicit markups. This is a neutral starting position which seems to be implied by § 3622(b)(1), a fair and equitable schedule. It is consistent with the Commission's general policies that the rates for each rate category be above cost; that rates reflect the costs developed in the record; and that rate design results in identifiable relationships between rate categories. Equal implicit markups, however, are only a starting place, and often may not be practicable or appropriate. The Commission frequently has good reason to depart from them in actual practice.

- a. Please explain whether you believe that the rate design for letters and flats should begin with equal implicit markups, and "depart" only for good reason.
- b. Please explain why it is fair and equitable to depart from equal implicit markups for letters and flats and limit the passthrough to 73 percent.
- c. Please explain whether it is appropriate to view the deliberate selection of a passthrough for the letter/flat differential that is below the cost coverage of the subclass and/or that is below 100 percent as elevating the rates for letters so that the rates for flats can be lower.
- d. Please explain how elevating the rate for a letter above the rate that the Commission says it "begins with" helps set appropriate rates for letters.

Response:

- a. The Postal Service believes that the requirement to maintain a fair and equitable schedule of rates is a requirement that pertains to the final rates themselves and not to the process used to arrive at the rates. In general the Postal Service's view is that it is appropriate to begin with the existing rates, since those rates have already been determined to be fair and equitable by the Commission.
- b. Please see my response to VP/USPS-T28-11a.
- c. Not necessarily. To take this view, one would have to assume that if the passthrough percentage were set at 100 percent or at the cost coverage of the subclass, the rates for letters would be lower, and vice-versa. This assumption

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

cannot be made without specifying a host of other assumptions. It would not be reasonable to make these assumptions unless provided with all the detailed circumstances pertinent to the rate case in question.

- d. Please see my response to VP/USPS-T28-11a.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-12.

Please consider the case of the letter/nonletter rate differential, which was first established with a passthrough of 50 percent in Docket No. R90-1 (Op. & Rec. Dec., p. V-230, ¶ 5941), which the Commission stated it does not view as a worksharing differential, and which the Commission subsequently stated should have a passthrough greater than 73 percent. Please note that in recommending a letter/nonletter differential that went from zero percent to 50 percent in one step, the Commission said that this "adjustment mitigate[d] the rate increase for required flats." In view of the Commission's stated position, as cited above, please explain:

- a. How many years should it take to get this differential up to a level of at least 100 percent?
- b. How should the maximum size of each step toward that goal be determined?
- c. Does the Postal Service believe that the rationale for the notion of an across-the-board increase should override these considerations and put off once again an opportunity to take further steps that would increase this passthrough?

Response:

- a. This question cannot be answered in the absolute. Each time it proposes Standard Mail rates, the Postal Service evaluates the proposed letter-flat rate differential in light of many factors, including the previous rate relationship, rate of change in rates, and other factors, as well as the cost differential. The Postal Service does not believe that a rigid timetable, or predetermined set of steps, best serves the interests of all its customers.
- b. Please see my response to VP/USPS-T28-12a.
- c. The Postal Service believes that its rationale for the proposed across-the-board rate increase is justified and most appropriate under the unique circumstances of this case. See the testimony of witness Potter (USPS-T-1). The Postal Service intends to address the letter-flat differential, along with other pertinent rate relationships when it files its next omnibus rate case.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-13. Please refer to Exhibit USPS-28A, page 16, Table 5, where you propose for Standard Regular letters a presorted Basic rate of \$0.282 and a 3/5-digit rate of \$0.261. The current Standard Regular 3/5-digit discount of 2.0 cents would be increased to 2.1 cents under the Postal Service's proposal.

- a. Please confirm that the rate differential of 2.0 cents between Presorted Basic and Presorted 3/5 is developed, after rounding, by applying a passthrough of 158 percent to a cost difference of 1.238 cents, as shown in cells E21 through G21 on the "PRE DIS" sheet of file USPS-LR-J-WP1.xls in library reference USPSLR-J-132 of Docket No. R2001-1. If you do not confirm without reservation, please explain the origin and the development of the current 2.0-cent figure and also explain the use made of the above-referenced cells.
- b. Please confirm that the 1.238-cent cost differential is the difference between a cost for Basic letters of 13.913 cents (equal to the sum of 4.201 cents for delivery and 9.712 cents for mail processing) and a cost for 3/5-digit presort letters of 12.675 cents (equal to the sum of 4.418 cents for delivery and 8.257 cents for mail processing), as shown on the 'COST' sheet of the file and library reference cited above. If you do not confirm without reservation, please explain the origin and the development and the components of the 1.238-cent cost differential.

Response:

- a. I did not prepare the Docket No. R2001-1 workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. I can confirm the calculation described in the question.
- b. I did not prepare the Docket No. R2001-1 workpapers cited in the question, nor were they prepared under my supervision, but I have examined them. I can confirm the calculation described in the question.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Page 1 of 4

VP/USPS-T28-16.

Please consider the following hypothetical. Suppose that: (i) a subclass has two categories of equal volume; (ii) the average unit cost of the subclass is 10 cents; (iii) the identified cost difference between the two categories is 4 cents (meaning that cost differences not studied by the Postal Service could exist and, if recognized, would make the known cost difference greater than 4 cents); and (iv) the cost difference of 4 cents is to be used on a defensible basis to de-average and institute separate rates for each of the two categories.

- a. Would you agree that the information known about the two categories suggests an **implied** unit cost for the higher-rated category of 12 cents and an **implied** unit cost for the lower-rated category of 8 cents? That is, 8 cents and 12 cents are **implicit** unit costs for each category, **implied** by what is known about the average cost, the difference in cost between the two categories, and the volume of each category. If you do not agree, please state all reasons for disagreement and explain why the **implicit** unit cost for each category cannot be developed in the manner described.
- b. For any rate categories of ECR and/or Standard Regular mail, has the Postal Service developed any estimates of **implicit** unit costs, based on estimates of cost differences or cost avoidances, along with any identified and understood set of assumptions, either on a basis similar to that described in preceding part a or on any other basis? If the answer is yes, please provide them. If the answer is no, please explain why such a seemingly relevant figure has not been developed.
- c. Please suppose that a cost coverage of 100 percent were to be selected for a subclass, and all passthroughs associated with discounts, as well as any other rate differences based on cost differences, were set at 100 percent. Would you agree that the result would be a set of at-cost rates, taking "at-cost rates" to mean that the rates are equal to costs, with no markups? If you do not agree, please state all reasons for disagreeing and identify any difficulties that, in your opinion, cannot be dealt with by making plausible assumptions and then stating that the results are contingent on those assumptions.
- d. Has the Postal Service developed such an at-cost set of rates for any categories of ECR or Regular Standard mail, possibly including stated assumptions about how to set at-cost pound rates and how at-cost Nonprofit rates should be developed? If the answer is yes, please provide them. If the answer is no, please explain why such a seemingly relevant figure has not been developed.

Response:

- a&b. The Postal Service has proposed and the Commission has recommended de-averaging between rate categories and established new subclasses based on

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Page 2 of 4

market characteristic and cost differences in the past, and are expected to do so when circumstances warrant. The purpose of this particular filing is not to enter into a discussion on the merits of rate design and classification changes. As stated in witness Potter's testimony, the focus of this case is narrowly defined, i.e., to generate enough revenue to fulfill the mandated escrow requirements.

Further, even if this rate proposal did not involve the special circumstances explained by witnesses Potter (USPS-T-1) and Robinson (USPS-T-28), rate design does not require the determination of implicit costs by rate category within a subclass. The Postal Service has not developed costs in the manner described. Regarding the hypothetical example provided in your question I would like to offer a few observations.

Our data systems develop reasonably reliable marginal (and incremental) costs for the subclasses. Workshare cost savings are estimated using special cost models isolating specific workshare parameters such as finer presort, automation compatibility (barcodes and machinability) and dropshipment of mail closer to destination. These studies allow the Postal Service to recognize the efforts of mailers to make mail cheaper for the Postal Service to process, transport, and deliver.

Second, average cost differences are not always due to cost avoidances. Cost differences can accrue due to valid cost avoidances caused by the additional work performed by the mailers or they could occur because of the

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Page 3 of 4

inherent characteristics of the two categories being compared. For instance, savings due to a certain worksharing parameter, e.g., presence of the barcode on a mail piece, could be estimated to be a negative number if the mail mix is not held constant in order to estimate the savings. In other words, barcoded mail as a group could cost more to process than non-barcoded mail. This is obviously an extreme example but one within my range of experience.

Third, the premise set forth in item (iii) of the question is flawed. Identified cost differences are just that: cost differences that can be identified. If the cost differences that could be identified amounted to four cents, then we should be unable to say a priori whether other unidentified cost differences would serve to augment the identified cost differences (as assumed in (iii)) or diminish them. Because of this limitation, the concept of implicit unit costs based, as it is, on 'identified' cost differences can only have a limited use for the purposes of developing pricing.

- c. No, the rates would not all necessarily be at 100 percent of total costs, by category, unless the hypothetical situation is defined as knowing that all of the remaining cost grouping (beyond the subset that has the 4-cent differential) are equal for all rate categories.
- d. The Postal Service has not developed such a set of at-cost rates. Given that Standard Mail is required to make a significant contribution to the Postal Service's institutional costs (over \$9 billion, according to witness Robinson

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Page 4 of 4

(USPS-T-27)), developing a set of rates that would yield absolutely no contribution would be pointless.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-17. Please address the following questions relating to costs, economic efficiency, and competition:

- a. Does the Postal Service agree that, laws permitting, competitors are more likely to compete for categories of mail that are priced substantially above cost than for categories of mail that are only moderately above cost, *i.e.*, the distance above cost, however expressed, is related to the likelihood and the intensity of competition? If not, please explain your reasons.
- b. Does the Postal Service agree that the costs underlying rate categories, particularly if they are estimates of marginal costs, are the appropriate links of the rates to the efficiency of resource allocation and to notions of economic efficiency in rates, and that this fact adds substantially to the importance of costs. If not, please provide all reasons for disagreeing and explain how interests in such efficiency and efficiency-related notions should be examined.
- c. Does the Postal Service agree that, except for consideration of externalities, it would be most economically efficient to set rates **equal** to marginal costs, even though that may not be a permissible option under current law? If not, please provide references to the economic literature showing that economic efficiency requires that rates be set at some other level.
- d. Please assume that there are no cross elasticities and that all own-price elasticities are at the same non-zero level. Now consider two markup measures: Measure **A** is the per-piece (unit) markup, as in the rate being 6 cents above cost, and Measure **B** is the percentage markup, as in rates being 30 percent above cost (implying a cost coverage of 130 percent).
 - (i) If one were interested in improving the efficiency of resource allocation and in reducing losses in economic efficiency, please explain which of the two measures would be most useful in gauging the distance of the rates from their costs, *i.e.*, which measure of distance-above-costs is indicative of the efficiency loss associated with the rate?
 - (ii) Under the elasticity assumptions of this question, would you agree that all rates should have the same percentage markup, but not the same perpiece markup. If you do not agree, provide references to the economic literature supporting your position.
 - (iii) Please explain whether you agree that, even if the elasticity assumptions are relaxed and the efficiency formulas become more complex, it is still measure **B** and not measure **A** that has a reasonably simple and straightforward relation to notions of economic efficiency.
 - (iv) Please explain whether you agree that under notions of economic efficiency, absent externalities and cross elasticities, one could say that the more elastic products would have a lower measure **B** (cost coverage) but one could not say whether the more elastic products would have a lower measure **A** (per-piece (unit) markup).

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

Response:

- a. If the costs in question are the Postal Service's costs, the answer is not necessarily. The relevant price-cost margins to a competitor would be (i) the margin between the prices and the competitor's own costs and, (ii) the margin between the prices and other competitors' costs. If the costs in question are those of the competitors themselves, it is reasonable to assume that, over some range, higher prices would stimulate competition, *ceteris paribus*.
- b. The Postal Service agrees that the relationship of marginal costs to rates is a fundamental relationship in determining whether pricing will promote efficient resource allocation. This important role underlines the importance of accurately determining the relevant costs, particularly marginal costs.
- c. Not necessarily. It is well known that for businesses where marginal costs are below average costs (typical of network-based firms like the Postal Service), setting prices equal to marginal costs would not generate enough revenue to cover the firm's total costs. To continue to operate over the long term, a subsidy would be necessary. The funds for the subsidy would have to be raised by taxes, which themselves (except for the lump-sum tax) impose their own economic inefficiencies and distortions. It is an open question whether marginal cost pricing requiring subsidies would be the most economically efficient pricing scheme for a network-based business.

The problems of marginal cost pricing for firms with falling average costs are well understood in Economics and are presented in undergraduate textbooks. See, for example, the introductory Economics textbook, Economics by Paul Samuelson and William Nordhaus, McGraw-Hill, 1989, Chapters 24 and 33.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAH H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-18.

Please refer to the following statement from the Commission's *Opinion and Recommended Decision* in Docket No. MC95-1, pages V-161-62, ¶ 5388, in reference to a separate automation subclass of Standard Mail:

The alternative of creating separate subclasses and considering the issue of lowest combined cost when selecting the associated markups is not a rational alternative. Selecting the markups in such a constrained way provides rates that are no different from those that result from offering worksharing discounts through rate categories.... One has to question the logic of creating subclasses and then constraining the outcome in accordance with a result that would be obtained without creating the subclasses.

- a. Please explain whether the cost coverages of the current ECR and Regular Standard subclasses, whose relative levels are being perpetuated by the across-the-board proposal, are or should be constrained in any way to achieve "a result that would be obtained without creating the subclasses."
- b. Has the Postal Service done any analysis to determine whether the proposed ECR rates differ from those that would likely exist if ECR had **not** been made into a separate subclass? If so, please provide that analysis.
- c. Suppose it were shown convincingly that the current ECR rates are higher than the rates for equivalent rate categories would be if a separate subclass had not been created. How would you view such a finding, and what should be done about it? Please provide all reasons for the view taken.
- d. If an ECR subclass had not been created, and the category passthroughs were 100 percent in line with oft expressed Postal Service and Commission preferences for mature subclasses, do you believe that the per-piece (unit) markups for the various categories would be approximately equal? If you disagree, please state all reasons for disagreeing. (For purposes of this question, the per-piece (unit) markup of a category is the revenue of the category minus the implicit cost of the category. The implicit cost of the category is the cost implied by the cost of the parent subclass and the cost differences to which the passthroughs are applied. For example, if a subclass costing 10 cents were composed of two equal-size categories with a cost difference to be used for ratesetting purposes of 4 cents, it would be implied that the cost of one category is 8 cents and the cost of the other category is 12 cents. See *also* Op. & Rec. Dec., Docket No. R2000-1, p. 390, ¶ 5534.)
- e. Has the Postal Service done any analysis comparing the implicit per-piece (unit) markups for the rate categories within **ECR** mail? If so, please present that analysis.
- f. Has the Postal Service done any analysis comparing the implicit per-piece (unit) markups for the rate categories within **Standard Regular** mail? If so, please present that analysis.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

- g. For the proposed rates, please provide a table showing the implicit per-piece (unit) markups for each rate category within ECR and Regular Standard mail.

Response:

- a&b. Redirected to witness Robinson, USPS-T-27.
- c. The Postal Service believes that pricing, though guided by general overarching principles, must address the contemporaneous needs of the Postal Service and its customers. The Postal Service finds itself in a different world today than when the ECR subclass was created, and its pricing proposals since then have responded to the situations as they presented themselves over time. It is impossible to say with any reasonable certainty what the appropriate rates for mail that currently uses the ECR (or any other) subclass would have been today had no separate subclass been developed. Since the premise of the question is impossible to verify, the question itself becomes purely speculative and unanswerable.
- d. Please see my response to VP/USPS-T28-18c. The question is purely counterfactual and does not specify all the factors and information the Postal Service takes into account when it makes its pricing proposals. Without complete information, any specific response would be impossible.
- e. No.
- f. No.
- g. The Postal Service has not produced such a table.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-19. Please refer to spreadsheets "COST" and "NCOST" in files USPS-LR-J-131-WP1.xls and USPS-LR-J-131-WP2.xls, respectively, of library reference USPS-LR-131 in Docket No. R-2001-1, which provide cost information behind the current commercial ECR and Nonprofit ECR rates that are proposed to be increased by any an approximately equal across-the-board percentage amount in this docket. Column G in each or the two above-referenced spreadsheets shows delivery costs. Please provide a specific source for each delivery-cost cell in both sheets; *i.e.*, one for commercial ECR and the other for Nonprofit ECR. Note that the source for these delivery cost data shown on the each respective spreadsheet may not be correct. Note also that library reference USPS-J-LR-117 in Docket No. 2001-1 is a candidate source, but does not appear to show separate costs for commercial ECR and Nonprofit ECR.

RESPONSE:

I did not prepare the workpapers cited in the question, nor were they prepared under my supervision, but I have reviewed the spreadsheets cited in the question. I have also noted that these spreadsheets were replaced by updated versions during the course of Docket No. R2001-1. The updated versions of the spreadsheets are available on the Commission's website for Docket No. R2001-1, in the Library References section under USPS-LR-J-131, by accessing the link entitled Notice of Filing Errata to USPS-LR-J-131, dated 1/3/2002. The updated spreadsheets give identical delivery costs for ECR and NECR and show the specific sources for the data in Footnote (2) on each spreadsheet. The sources cited in those footnotes are: USPS-LR-J-58, Workbook LR-J-58.xls, Summary and USPS-LR-J-117.xls, Table 1. I do not know the source of the previous, erroneous data.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-20. Please consider the current rate relationships for non-dropshipped (nationwide) **letters**, focusing specifically on the prebarcoded 5-digit rate in the Standard Regular subclass, and in the ECR subclass on the Basic carrier route rate and the prebarcoded Basic carrier route rate, relationships which would be perpetuated through the across-the-board approach behind the proposed rates. The specific rates involved are shown in the following table, in cents per piece:

	Standard Regular <u>Barcoded 5-digit</u>	Standard ECR <u>CR Basic</u>	Standard ECR <u>Barcoded CR Basic</u>
Current	19.0	19.4	17.1
Proposed	20.0	20.4	18.0

Please refer to the testimony of Postal Service witness Laraine B. Hope, Docket No. R2001-1, USPS-T-31 at pages 2-3, where she states: "An example of an appropriate rate relationship is that the proposed ECR basic letter rate is slightly higher than the 5-digit automation letter rate in the Regular subclass. This maintains the current rate relationship and encourages the use of automation by mailers." Witness Hope's statement suggests that the ECR Basic rate (19.4 cents) should be slightly higher than the barcoded 5-digit rate (19.0 cents), in order to encourage the use of automation.

- a. Please explain whether the Postal Service is concerned that if the rate relation between these two were in the opposite direction, some barcoded 5-digit letters might leave the automation program and convert to ECR Basic letters. If this is a matter of concern, please explain the ways in which a mailer of barcoded 5-digit letters might succeed in qualifying for the ECR Basic rate.
- b. If there is concern that Standard barcoded 5-digit letters might leave the Standard barcoded 5-digit category and move to the ECR subclass, please explain why the logical place to move would not be the barcoded ECR Basic category instead of the ECR Basic category.
- c. If there is concern that Standard barcoded 5-digit letters might move to the barcoded ECR Basic category, please explain how this would have a negative effect on the Postal Service's automation program.
- d. If there is a desire to encourage ECR Basic letters to move to the Standard barcoded 5-digit category, please explain why the logical automation category for these pieces would not instead be the barcoded ECR Basic category.
- e. If there is concern over some other movement among the rate categories discussed above, a movement not mentioned herein, please explain what that movement is and the basis for the concern.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-20 (continued):

- a. The rate design reflects the concern that 5-digit automation letter preparation is preferable (from a mail processing point of view) to Basic ECR preparation (5-digit automation letter mail can much more readily be sequenced with other letter, thereby enhancing overall automated sorting.) If a mailer of 5-digit automation letters has the density to qualify for ECR, which is likely, then the mailer could qualify for ECR prices.
- b. The automation rate category in ECR is of limited availability, so it is not a logical place to which 5-digit letters would move.
- c. See the response to subpart (b). To the extent that pieces move to the Automation Basic category, this is not necessarily a negative for the automation program. Again, these items can be readily sequenced with other automation letters. In most instances, basic ECR letters have to be merged manually with other letters.
- d. See the response to subpart (b). Basic Automation in ECR is only for those locations where carrier route preparation is advantageous over 5-digit preparation, so it is not the logical category.
- e. Not applicable.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

- VP/USPS-T28-21.** Please suppose the rates for (i) ECR Basic letters and (ii) Regular prebarcoded 5-digit letters (rates also referenced in VP/USPS-T28-20) were based on their costs and a markup rooted in an independent application of the non-cost factors in the Postal Reorganization Act, with an outcome that the ECR Basic rate were lower than the Regular prebarcoded 5-digit rate.
- a. Please explain whether it is the Postal Service's position that an additional layer of rate design guidance should be applied in order to push the ECR Basic rate for letters higher so that any mail using the rate is precluded from receiving recognition of its costs and the independent application of the non-cost factors in the Postal Reorganization Act. If this is the Postal Service's position, please explain all reasons and bases for this position.
 - b. If the layering described in part a is the Postal Service's position, please explain how it is fair to mailers using the ECR Basic rate, who must accordingly pay higher rates.
 - c. Please explain whether the Postal Service sees elevating the cost coverage of the ECR subclass as one way to help achieve a rate for ECR Basic letters that is higher than the rate for Regular prebarcoded 5-digit letters. If so, please explain the basis for this higher coverage and how it is fair to mailers of other letters using the ECR subclass, to ECR mailers of non-letters, and to mailers of all Nonprofit ECR materials.
 - d. Within the confines of a specific cost coverage for the ECR subclass, please explain whether the Postal Service agrees that any process of elevating the ECR Basic letter rate at the same time necessarily has the effect of providing lower rates for the non-letters in ECR. If it does agree, please discuss and explain the basic economic fairness of elevating letter rates in a way that provides lower rates to non-letters. If it does not agree, please explain the steps that are taken, and the steps that should be taken, to make it otherwise.
 - e. If the Postal Service has an interest in achieving a rate for ECR Basic letters that is higher than the rate for Regular prebarcoded 5-digit letters, please explain why it is not just as logical and just as fair to artificially **lower** the rate for 5 Regular prebarcoded 5-digit letters as it is to artificially **increase** the rate for ECR Basic letters.

RESPONSE:

- a. No. The question appears to suggest that the Postal Service uses an "additional layer" of rate design guidance after all the cost and non-cost factors of the Postal Reorganization Act have been applied. This is not the case. The Postal Service's view is that both cost and all of the other pricing factors in the Act give guidance to the rate design below the subclass level. The rates for ECR Basic letters, including the relationships of these rates to

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-21 (continued):

~~b.~~ other rate categories, appropriately recognize both the category's costs as well as non-cost factors.

b. ~~c.~~ Please see my response to subpart (a).

c. ~~d.~~ Redirected to witness Robinson.

d. ~~e.~~ While I do not accept that the rate setting methodology outlined in the question accurately or adequately describes the Postal Service's rate setting approach, I can attempt to respond to the question as an abstract hypothetical. All else equal, a higher price for the Basic tier could lead to lower prices for at least some of the other rate categories in High-Density or Saturation. It does not necessarily mean that nonletters in those categories would have lower prices.

e. ~~f.~~ Please see my response to VP/USPS-T28-20. The Regular Automation 5-digit letter rate is not the sole (or even a major) reference point in the rate design for ECR Basic letters. Rate relationships, including the relationships between ECR Basic letters and Regular Automation 5-digit letters, are taken into account in the rate design for both rate categories, and may merely involve a check to see if the appropriate relationship is present at the end of the rate design process.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-22. One could argue that Standard ECR rates (including those for ECR Basic letters) might be lower than Standard Regular rates (including those for Prebarcoded 5-digit letters) due to factors such as lower costs, higher elasticity, lower value of service, the recognition of competition, the recognition of market characteristics, and an interest in making the rates more market-based, much as the Postal Service argued in support of the creation of the ECR subclass in Docket No. MC95-1.

- a. If the ECR rates are elevated on some other basis to make them higher than certain non-ECR rates, please explain whether it would be the Postal Service's position that mailers using the elevated rates, including Nonprofit ECR mailers, would be deprived of having these various factors recognized in their rates.
- b. In Docket No. MC95-1, in support of creating a separate ECR subclass, the Postal Service argued that the "Current Subclasses Are Heterogeneous," that "Efficient Mail Pays [a] Disproportionate Contribution," that "Efficient Mail Is Most Susceptible to Non-USPS Delivery," that "Efficient Mail Must Be Retained to Maintain Reasonable Rates for All," that "the most likely incursions into the existing customer and volume base will occur in those areas where the unit cost for delivery is less than the average but is not adequately reflected in price, giving competitors an opportunity to price their services to attract the 6 lower cost Postal Service products out of the mailstream," that "The Enhanced Carrier Route subclass is a first step to counter that competitive strategy," and that "The most vulnerable volume in the mailstream today is that which exhibits a higher degree of delivery density than average, because high delivery density will produce a lower than average unit delivery cost for a competitive hard copy delivery service." (Docket No. MC95-1, Direct Testimony of Postal Service witness Charles McBride, USPS-T-1, pp. i and 29-30, emphasis added.)
 - (i) Do you believe that, when the Postal Service made these arguments, it believed the rates for ECR mail generally would be lower than they would be without the creation of the new subclass?
 - (ii) Do you believe that, in Docket No. MC95-1, the Postal Service anticipated that the rates for ECR mail would be elevated so that certain rate elements could be higher than related portions of non-ECR mail?
 - (iii) When the Postal Service said that creating ECR is a "first step," please explain what you believe that the additional steps would be, and, over what time frame these steps might occur, and whether these steps would involve a lowering of the ECR markup and the ECR rates.
 - (iv) Please explain the extent to which the Postal Service does or would at some point regard creation of the ECR subclass as unsuccessful in achieving its objectives as stated above if ECR rates are not lower than they would have been without the creation of the ECR subclass.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-22:

- a. Please see my response to VP/USPS-T28-20. I would observe that ECR rates are much lower than Standard Mail Regular rates on the whole. It would be inaccurate to interpret the Postal Service's arguments in Docket No. MC95-1 to mean that every ECR rate element would always fall below every Regular subclass rate element. Specific ECR rate categories (as well as specific non-ECR rate categories) are developed taking into account the factors cited in the preamble to this question together with all the other cost and non-cost pricing factors cited in the Postal Reorganization Act.
- b.
 - (i) Yes.
 - (ii) I am not in a position to know, nor do I have any information to inform me, whether the Postal Service, in 1995, anticipated the future rate relationship between 5-digit automation and Basic ECR. I would note that for me, it is difficult to predict with certainty that particular rate relationships are sacrosanct given a dynamic environment.
 - (iii) When the Postal Service proposed creating a separate ECR subclass, the idea was to develop a mechanism that would more easily allow the specific cost and market characteristics to be accounted for in rates. When the Postal Service described the subclass creation as a "first step," it had building this capability in mind, rather than a particular succession of subsequent "steps" with an accompanying timetable for implementation.

Regarding ECR rates, I would note that the price of a DSCF saturation letter has increased only 3.3 percent in nominal terms in the ten years since January of 1995. For comparison purposes a commercial Regular subclass presorted rate DSCF 3/5 letter increased 32.1 percent and a Regular automation DSCF 3-digit letter increased 14.2 percent. Over the same period the CPI increased 26.9 percent. This means that the real price for ECR saturation letters decreased by 18.6 percent. Similar results hold for non-drop shipped letters: ECR

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-22 (continued):

saturation letters increased 7.0 percent compared to 31.9 percent for presorted 3/5 letters and 16.0 percent for automation 3-digit letters. I believe that the creation of the ECR subclass has been successful in holding down the real price of ECR letter mail since its creation.

- (iv) Please see my response to subpart (iii). I have seen no evidence suggesting that rates for pieces in today's ECR would have been lower today had the ECR subclass not been created, so I see no reason for the Postal Service to conclude that the ECR subclass has been unsuccessful in achieving its objectives.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-28. Please refer to USPS-LR-K-115, workbook USPST28Aspreadsheets.xls, and to USPS-LR-K-114, the latter showing final "Markups" and "Markup Indices."

- a. On spreadsheets such as "S-7 Comm. Piece-Pound Dist.-BY," please confirm that the volumes shown for "Nonmachinable" letters are shown for purposes of applying the surcharge only and that the same volumes also are included in the corresponding categories of "Presorted" letters. Please explain fully any non-confirmation.
- b. Please explain whether the "Markups" and "Markup Indices" shown in USPS-LR-K-114 include the fees in the revenues used to calculate them. If they do not, please provide a revised reference showing the markups and indices with the fees included.
- c. Please provide a source for each of the percentage figures in columns D and E of the second sheet of USPS-LR-K-114.

RESPONSE:

- a. Confirmed.
- b. Redirected to witness Robinson.
- c. Redirected to witness Robinson.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-29. Note 2 of Rate Schedule 321B says: "Letters that weigh more than 3.3 ounces but not more than 3.5 ounces pay the nonletter piece and pound rate but receive a discount off the piece rate equal to the applicable nonletter minimum piece rate minus the applicable letter minimum piece rate corresponding to the correct presort tier." Similar notes appear in Rate Schedules 322, 323B, and 324.

In view of the above statement found in notes to Rate Schedules 321B, 322, 323B, and 324, please refer to USPS-LR-K-115, workbook USPST28Aspreadsheets.xls, and explain whether the rate entries indicated below conform with that statement:

- (i) Sheet 'S-17 Adjusted Comm. Rates,' cells I11 through K11;
- (ii) Sheet 'S-20 Adjusted Nonprofit Rates,' cells I10 through J10 and I13 through K13;
- (iii) Sheet 'ECR-16 Adjusted ECR Rates,' cells I10 through L10; and
- (iv) Sheet 'ECR-19 Adjusted NECR Rates,' cells I11 through L11. 15

RESPONSE:

- (i) No. The per-piece rate elements in question were developed by applying the proposed 5.4 percent increase factor to current rate elements and then rounding the result to tenths of a cent, rather than by applying the formula. Had the formula been applied, each of the per-piece rate elements in question would have been equal to \$0.069, rather than \$0.070. The Postal Service believes that either approach yields reasonable and fair rates and that the two sets of rates are not significantly different in terms of their impact on mailers or on Postal Service revenues.
- (ii) No. The per-piece rate elements in question were developed by applying the proposed 5.4 percent increase factor to current rate elements and then rounding the result to tenths of a cent, rather than by applying the formula. Had the formula been applied, each of the per-piece rate elements cited in row 10 of the workpapers would have been equal to \$0.026, rather than \$0.025, and each of the per-piece rate elements cited in row 13 of the workpapers would have been equal to (\$0.007), rather than (\$0.006). The Postal Service believes that either approach yields reasonable and fair rates and that the two

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-29 (continued):

- (iii) sets of rates are not significantly different in terms of their impact on mailers or on Postal Service revenues.
- (iv) No. The per-piece rate elements in question were developed by applying the proposed 5.4 percent increase factor to current rate elements and then rounding the result to tenths of a cent, rather than by applying the formula. Had the formula been applied, each of the per-piece rate elements in question would have been equal to \$0.048, rather than \$0.047. The Postal Service believes that either approach yields reasonable and fair rates and that the two sets of rates are not significantly different in terms of their impact on mailers or on Postal Service revenues.
- (v) No. The per-piece rate elements in question were developed by applying the proposed 5.4 percent increase factor to current rate elements and then rounding the result to tenths of a cent, rather than by applying the formula. Had the formula been applied, each of the per-piece rate elements in question would have been equal to \$0.028, rather than \$0.027. The Postal Service believes that either approach yields reasonable and fair rates and that the two sets of rates are not significantly different in terms of their impact on mailers or on Postal Service revenues.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-31. Rate Schedule 321A, note 6, and Rate Schedule 321B, note 4, state: "Add \$0.015 per piece for pieces bearing a Repositionable Note as defined in Classification Schedule 321.8."

- a. Please explain whether this "note" also should appear in any other Rate Schedules of Standard mail.
- b. Will the revenue from Repositionable Notes accrue to the category of Standard mail in which they are used? Please explain any answer that is not an unqualified affirmative.
- c. Please explain how and where the revenue from Repositionable Notes is recognized in the Postal Service's proposal.
- d. Please explain when and in what form information relating to the volume and revenue of Repositionable Notes will become available.

RESPONSE:

- a. Yes. Appropriate RPN notes should have been included in Standard Mail schedules 322, 323A, 323B, and 324.
- b. Yes.
- c. Repositionable Notes revenue is not projected in this docket since RPN service has only been recently introduced and is currently undergoing testing in the form of a one-year market test. There was no projection of revenue in the RPN case, and it is not expected to have a significant impact in the Test Year.
- d. See Docket No. MC2004-5, USPS-T-1, page 6, "Data Collection Plan."

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-32. Rate Schedule 321A, note 5 says: "Pieces entered as Customized Market Mail, as defined in DMCS section 321.22, are subject to the nondestination entry, nonletter minimum per-piece basic rate and the residual shape surcharge."

- a. Aside from Rate Schedules 321A and 323A, should this note appear in any other rate schedules?
- b. Please explain how and where the Postal Service's proposal recognizes the revenues and costs of Customized Market Mail.
- c. By subclass and time period, please provide any summary information available on the revenues and costs of Customized Market Mail since it was approved for implementation.
- d. Please explain when additional information on the use of Customized Market Mail in calendar 2005 will become available.

RESPONSE:

- a. No.
- b. The revenues and costs for Customized MarketMail (CMM) pieces are included with other Standard Mail nonletter revenues and costs.
- c. See the revenue and volume data for CMM below. The Priority Mail revenues are revenues for drop shipping the CMM pieces to delivery units.

CMM REVENUES AND VOLUMES

Period	Pieces	Standard Mail Postage
FY 2004	3,162,367	\$1,798,354
FY 2005 Q1&Q2	1,134,289	\$ 646,423

- d. CMM revenue and pieces data will be available on a quarterly basis, generally about six weeks after the close of the quarter.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-33. Please refer to the Rate Schedule shown in Postal Service's Request, Attachment A, page 18, and explain whether it should be identified as "Schedule 323A."

RESPONSE:

Yes, it should be identified as "Schedule 323A."

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-34. For Standard (Commercial) Regular mail, has the Postal Service computed the aggregate "leakage" (*i.e.*, discounts earned by mailers) during Base Year 2004? If so, please provide the aggregate amount of such discounts from (i) presort and automation, and (ii) destination entry.

RESPONSE:

The Postal Service has not calculated this "leakage" for BY 2004. However, if one wanted to perform these calculations, they could be done using rate design formulas contained in the Postal Service's Standard Mail Regular workpapers filed in Docket No. R2001-1, in particular, the formulas in the Tabs "DROP DIS," "PRE DIS," and "RES SHAPE LEAK."

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-35. For Standard Nonprofit Regular mail, has the Postal Service computed the aggregate "leakage" (*i.e.*, discounts earned by mailers) during Base Year 2004? If so, please provide the aggregate amount of such discounts from (i) presort and automation, and (ii) destination entry.

RESPONSE:

The Postal Service has not calculated this "leakage" for BY 2004. However, if one wanted to perform these calculations, they could be done using rate design formulas contained in the Postal Service's Standard Mail Regular workpapers filed in Docket No. R2001-1, in particular, the formulas in the Tabs "DROP DIS," "PRE DIS," and "RES SHAPE LEAK."

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-36. For Standard (Commercial) ECR mail, has the Postal Service computed the aggregate "leakage" (*i.e.*, discounts earned by mailers) during Base Year 2004? If so, please provide the aggregate amount of such discounts from (i) presort and automation, and (ii) destination entry.

RESPONSE:

The Postal Service has not calculated this "leakage" for BY 2004. However, if one wanted to perform these calculations, they could be done using rate design formulas contained in the Postal Service's Standard Mail Regular workpapers filed in Docket No. R2001-1, in particular, the formulas in the Tabs "DROP DIS," "PRE DIS," and "RES SHAPE LEAK."

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-37. For Standard Nonprofit ECR mail, has the Postal Service computed the aggregate "leakage" (*i.e.*, discounts earned by mailers) during Base Year 2004? If so, please provide the aggregate amount of such discounts from (i) presort and automation, and (ii) destination entry.

RESPONSE:

The Postal Service has not calculated this "leakage" for BY 2004. However, if one wanted to perform these calculations, they could be done using rate design formulas contained in the Postal Service's Standard Mail Regular workpapers filed in Docket No. R2001-1, in particular, the formulas in the Tabs "DROP DIS," "PRE DIS," and "RES SHAPE LEAK."

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO VALPAK INTERROGATORY**

VP/USPS-T28-46. Table 1, set out below, is taken from the first spreadsheet of file LR-K-48STDLETRS.xls of library reference USPS-LR-K-48, showing workshare-related costs for various categories of letter-size Standard Regular mail at USPS costing. A corresponding table in Docket No. R2001-1 is in USPS-LR-J-60, revised November 15, 2001.

Table 2, set out below, shows the proportionate changes in costs from the corresponding table in Docket No. R2001-1 to those shown in Table 1.

For ease of reference, certain costs are shaded in each table. Please note that not all rows in the tables, including the indented rows, are for categories recognized in rates.

- a. Please confirm that if the Postal Service were designing rates for Regular letters, based on current costs, and were following the procedures of Docket No. R2001-1, it is the costs in the shaded rows in Table 1 that would be used. If you do not confirm, please present alternative costs, provide their source, and respond to the following parts of this question based on your alternative costs.
- b. Please refer to Table 2, column 3, and identify and discuss all factors accounting for the 97.586 percent increase in the worksharing-related delivery costs of nonautomation, nonmachinable letters at the mixed ADC, ADC, 3-digit, and 5-digit levels, such as factor prices, changes in productivity, changes in technology, changes in the methods and procedures used in costing, changes in the way the mail is handled, and any other factors. For all changes in costing method or procedure identified, please explain why the change is an improvement, and in particular how it improves the estimation of marginal cost and volume variable costs.
- c. Please refer to Table 2, column 3, and identify and discuss all factors accounting for the increase of only 0.649 percent in the worksharing-related delivery costs of nonautomation, machinable letters at the mixed AADC and AADC levels, such as factor prices, changes in productivity, changes in technology, changes in the methods and procedures used in costing, changes in the way the mail is handled, and any other factors. For all changes in costing method or procedure identified, please explain why the change is an improvement, and in particular how it improves the estimation of marginal cost and volume variable costs.
- d. In Docket No. R2001-1, the worksharing-related delivery costs were the same for nonautomation, machinable AADC letters and corresponding 3- and 5-digit letters. In Docket No. R2005-1, they are different, as shown in Table 1, column 3 — 3.879 cents for the first two and 3.682 cents for the last two.
 - (i) Please explain why these costs were the same before and now are different.
 - (ii) Are these Docket No. R2005-1 estimates considered to be marginal costs? If yes, please explain the assumptions

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO VALPAK INTERROGATORY**

VP/USPS-T28-46 (continued):

- necessary for them to be marginal costs. If no, please explain the costing theory behind the costs.
- (iii) If these costs are marginal costs, are they based on different mixes? Is an assumption being made that any extra pieces on which a marginal cost is based have the same mix (possibly involving processing proportions) as the existing pieces in the category? Please explain the basis for any such assumption.
- e. Please refer to Table 2, column 2. The increase of 31.029 percent in the worksharing-related mail processing cost of nonautomation Basic presort letters is a weighted average of its components, shown immediately below to be 38.702 percent, 35.312 percent, 22.109 percent, and 22.109 percent. Please identify and discuss all factors accounting for the increases of these four components, such as factor prices, changes in productivity, changes in technology, changes in the methods and procedures used in costing, changes in the way the mail is handled, and any other factors. For all changes in costing method or procedure identified, please explain why the change is an improvement, and in particular how well aligned it is with the concepts of marginal cost and volume variable costs. Please also discuss the role of delivery point sequencing as regards the extent of the increase in cost.
- f. Please refer to Table 2, column 2, last four rows. Despite inflation and increased delivery point sequencing, the worksharing-related mail processing costs of the four categories of automation letters (mixed AADC, AADC, 3-digit, and 5-digit) all decreased by, in the same order, 12.981 percent, 15.835 percent, 16.461 percent, and 20.623 percent. Please identify and discuss all factors accounting for these decreases, such as factor prices, changes in productivity, changes in technology, changes in the methods and procedures used in costing, changes in the way the mail is handled, and any other factors. For all changes in costing method or procedure identified, please explain why the change is an improvement, and in particular how well aligned it is with the concepts of marginal cost and volume variable costs. Please also discuss role of increased delivery point sequencing.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE TO VALPAK INTERROGATORY

VP/USPS-T28-46 (continued):

Attachment to VP/USPS-T28-46
Table 1

Table 1. Cost Estimates

RATE CATEGORY	Mail Processing		Delivery	Total
	Total	Worksharing	Worksharing	Worksharing
	Unit Cost	Related Unit Cost	Related Unit Cost	Related Unit Cost
	(1)	(2)	(3)	(4)
Nonauto Basic Presort Flats	23 148	n/a	9 290	32 438
Nonauto 3-Digit/5-Digit Presort Flats	14 528		9 290	23 818
Nonautomation Presort Letters	16 263	11 007	6 062	17 068
Nonautomation Basic Presort Letters	17 409	12 153	5 410	17 563
Nonautomation Nonmachinable Mixed ADC	37 485	32 229	11 049	43 278
Nonautomation Nonmachinable ADC	29 347	24 091	11 049	35 140
Nonautomation Machinable Mixed AADC	13 157	7 901	3 879	11 780
Nonautomation Machinable AADC	13 157	7 901	3 879	11 780
Nonautomation 3-Digit/5-Digit Presort Letters	15 022	10 614	6 284	16 899
Nonautomation Nonmachinable 3-Digit	26 409	21 153	11 049	32 202
Nonautomation Nonmachinable 5-Digit	17 812	12 556	11 049	23 605
Nonautomation Machinable 3-Digit	12 683	7 427	3 682	11 109
Nonautomation Machinable 5-Digit	12 683	7 427	3 682	11 109
Automation Mixed AADC Presort Letters	4 662	3 491	4 104	7 595
Automation AADC Presort Letters	3 943	2 772	3 890	6 662
Automation 3-Digit Presort Letters	3 691	2 519	3 794	6 313
Automation 5-Digit Presort Letters	2 817	1 646	3 538	5 184

Table 1. Cost Estimates

RATE CATEGORY	Mail Processing		Delivery	Total
	Total	Worksharing	Worksharing	Worksharing
	Unit Cost	Related Unit Cost	Related Unit Cost	Related Unit Cost
	(1)	(2)	(3)	(4)
Nonauto Basic Presort Flats	23 148	n/a	9 290	32 438
Nonauto 3-Digit/5-Digit Presort Flats	14 528		9 290	23 818
Nonautomation Presort Letters	16 263	11 007	6 062	17 068
Nonautomation Basic Presort Letters	17 409	12 153	5 410	17 563
Nonautomation Nonmachinable Mixed ADC	37 485	32 229	11 049	43 278
Nonautomation Nonmachinable ADC	29 347	24 091	11 049	35 140
Nonautomation Machinable Mixed AADC	13 157	7 901	3 879	11 780
Nonautomation Machinable AADC	13 157	7 901	3 879	11 780
Nonautomation 3-Digit/5-Digit Presort Letters	15 022	10 614	6 284	16 899
Nonautomation Nonmachinable 3-Digit	26 409	21 153	11 049	32 202
Nonautomation Nonmachinable 5-Digit	17 812	12 556	11 049	23 605
Nonautomation Machinable 3-Digit	12 683	7 427	3 682	11 109
Nonautomation Machinable 5-Digit	12 683	7 427	3 682	11 109
Automation Mixed AADC Presort Letters	4 662	3 491	4 104	7 595
Automation AADC Presort Letters	3 943	2 772	3 890	6 662
Automation 3-Digit Presort Letters	3 691	2 519	3 794	6 313
Automation 5-Digit Presort Letters	2 817	1 646	3 538	5 184

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO VALPAK INTERROGATORY**

VP/USPS-T28-46 (continued):

Attachment to VP/USPS-T28-46
Table 2

Table 2. Percentage Changes from Docket No. R2001-1

RATE CATEGORY	Mail Processing		Delivery	Total
	Worksharing		Worksharing	Worksharing
	Related		Related	Related
	Total Unit Cost	Unit Cost	Unit Cost	Unit Cost
	(1)	(2)	(3)	(4)
Nonauto Basic Presort Flats				
Nonauto 3-Digit/5-Digit Presort Flats				
Nonautomation Presort Letters				
Nonautomation Basic Presort Letters	33.531%	31.029%	28.615%	30.275%
Nonautomation Nonmachinable Mixed ADC	38.841%	38.702%	97.586%	50.124%
Nonautomation Nonmachinable ADC	36.077%	35.312%	97.586%	50.196%
Nonautomation Machinable Mixed AADC	28.577%	22.109%	0.649%	14.098%
Nonautomation Machinable AADC	28.577%	22.109%	0.649%	14.098%
Nonautomation 3-Digit/5-Digit Presort Letters	23.658%	26.571%	42.291%	31.994%
Nonautomation Nonmachinable 3-Digit	35.507%	34.504%	97.586%	51.050%
Nonautomation Nonmachinable 5-Digit	26.368%	21.513%	97.586%	48.226%
Nonautomation Machinable 3-Digit	28.447%	21.519%	-2.926%	12.157%
Nonautomation Machinable 5-Digit	28.447%	21.519%	-2.926%	12.157%
Automation Mixed AADC Presort Letters	-7.575%	-12.981%	5.583%	-3.846%
Automation AADC Presort Letters	-8.850%	-15.835%	1.646%	-6.440%
Automation 3-Digit Presort Letters	-8.837%	-16.461%	-0.472%	-7.534%
Automation 5-Digit Presort Letters	-9.303%	-20.623%	-5.350%	-10.800%

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO VALPAK INTERROGATORY**

RESPONSE to VP/USPS-T28-46 (continued):

- a. Confirmed that the designated costs would be some of the components used in developing prices, and therefore, discounts for Regular subclass letters.
- b-f. Redirected to the Postal Service.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO VALPAK INTERROGATORY**

VP/USPS-T28-47. Table 1, set out below, is taken from the first spreadsheet of file LR-K-48STDLETRS.xls of USPS-LR-K-48, and shows workshare-related costs for various categories of letter-size Standard Regular mail at USPS costing. For ease of reference, certain costs are shaded. Please note that not all of the lines in the table, including the indented lines, are for categories recognized in rates. A corresponding table in Docket No. R2001-1 is found in USPS-LR-J-60, revised November 15, 2001.

- a. Please confirm that if the Postal Service were developing discounts for automation (*i.e.*, prebarcoded) letters based on current costs, and were following the procedures used in Docket No. R2001-1, it is the workshare-related unit costs in the shaded rows of column 4 in Table 1 that would be used. If you do not confirm, please present the costs that would be used, provide their source, and respond to the following parts of this question.
- b. Please confirm that an automation discount for mixed AADC letters would be based on a cost difference of $17.563 - 7.595 = 9.968$ cents.
- c. Please explain the extent to which you view the discount for automation mixed AADC letters to be a worksharing discount. To the extent that you do not so view it, please explain why. To the extent that you do so view it, please explain the nature of the work that is being shared.
- d. To the extent to which you view the discount for automation mixed AADC letters to be a worksharing discount, please explain the extent to which you believe this discount should be based on a cost avoidance. If you do not believe it should be based on an avoidance, please explain why. If you do so believe, please explain how that avoidance should be defined, *i.e.*, its concept and the costs that should be used to implement the concept.
- e. Recognizing that the 17.563-cent workshare related cost for nonautomation presort letters shown in column 4 (and its mail processing and delivery components in columns 2 and 3) is a weighted average of the four costs shown immediately below it in the table, please explain the extent to which you view the cost difference of 9.968 cents to be an amount that would be avoided if a candidate basic presort letter shifts to become an automation mixed AADC letter.
- f. If an automation mixed AADC letter were to revert back to being nonautomation, is it your position that the Postal Service would experience an increase in cost of 9.968 cents? If you do, please explain how and why that cost increase would occur, and any assumptions on which it is based. If you do not, please explain why it is the appropriate cost on which to base the automation discount.
- g. As shown in Table 1, the workshare-related mail processing cost of (i) nonautomation, machinable letters is 7.901 cents at both the mixed AADC and AADC levels, and of (ii) corresponding automation letters is 3.491 cents at the mixed AADC level and 2.772 cents at the AADC level.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO VALPAK INTERROGATORY**

VP/USPS-T28-47 (continued):

- (i) Please explain how the difference between the costs of 7.901 cents and 3.491 cents, for mixed AADC letters, relates to the cost the Postal Service would incur to read the address and place a barcode on the nonautomation piece.
- (ii) Please explain why the worksharing-related mail processing cost of automation mixed AADC letters is 3.491 cents while the corresponding cost for AADC letters is only 2.772 cents.
- (iii) Please explain why the two nonautomation costs are the same while the two automation costs differ.

RESPONSE

- a. Confirmed that the designated cost would be one of the components used in developing prices, and therefore, discounts for automation letters.
- b. Confirmed that this is the mail processing and delivery unit cost differential between mixed AADC letters and nonautomation Basic Presort letters and that this cost difference would be part of the consideration when developing mixed AADC letter rate proposals.
- c. Rate differentials throughout the rate design for Standard Mail are routinely referred to as worksharing discounts. In this particular instance, in order to get the lower rate, the mailer must perform work that facilitates the automated handling of the letter.
- d. Please see my response to subpart c. The cost avoided due to the mailer preparing the letter in a manner to facilitate the automated processing of the letter should be the basis for this discount. Other factors may also be considered which may have the effect of increasing or decreasing the proposed rate differential.

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS TAUFIQUE
TO VALPAK INTERROGATORY**

RESPONSE to VP/USPS-T28-47 (continued):

The worksharing cost avoidance would be the difference in costs related to the work performed by the mailer to facilitate automated handling, as described in my response to subpart c.

- e. As the question indicates, the 17.563 cent figure is an average unit cost for a category of mail having a range of characteristics. As such, unit cost differences derived from it are not claimed to represent the estimated costs that would be avoided for any specific letter that might shift from the nonautomation Basic Presort letter category to any other rate category.
- f. Please see my response to subpart e. It not is my position that the 9.968 cent figure estimates the cost increase for any specific letter migrating from the Automation Mixed AADC rate category to the nonautomation Basic Presort rate category. However, as an estimate of the average cost difference between the two categories of mail, it would be a reasonable starting point from which to begin the process of designing rates for the two categories. Please see also my response to subpart a.
- g. Redirected to witness Abdirahman USPS-T-21.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-52. Please refer to your testimony (USPS-T-28) at page 11 where you describe the Postal Service's attempt to comply with the nonprofit pricing relationship requirement of Public Law 106-384, and you state:

With the proposed rates, the revenue per piece for Standard Mail Nonprofit Regular is 61 percent of the Standard Mail Regular revenue per piece; the revenue per piece for Standard Mail Nonprofit ECR is 56 percent of the Standard Mail ECR revenue per piece. [USPS-T-28, p. 11, ll. 18-21.]

Public Law 106-384 specifies that for calculating nonprofit rates, the 60 percent figure be applied to TYBR billing determinants. See 39 U.S.C. § 3626(a)(6)(B) and Docket No. R2000-1, Memorandum of the United States Postal Service on Reconsideration and Request for Expedition (December 20, 2000), pp. 32-34.

Please refer to USPS-LR-K-115, file USPST28Aspreadsheets.xls, worksheet 'S-23 TYAR Commercial Revenues.'

- a. In determining the revenue per piece for Standard (Commercial) Regular mail to be used as a basis for comparison with the revenue per piece of Standard Nonprofit Regular mail, when computing total revenues in the numerator, did you multiply the proposed rates for Standard (Commercial) Regular mail by TYBR billing determinants? If not, please state the billing determinants that you used, and explain the rationale for not using TYBR billing determinants. Also, for whatever billing determinants you used, please provide the total revenues that you used in the numerator of the revenue per piece computation for Standard (Commercial) Regular mail.
- b. Please provide the revenue per piece that you computed for Standard (Commercial) Regular mail, and state whether you divided the total revenues referred to in preceding part a by the TYBR volume of Standard (Commercial) Regular mail? If not, please state what volume figure you used in the denominator.
- c. If you did not calculate the revenue per piece of Standard (Commercial) Regular mail using TYBR billing determinants in both the numerator and denominator, please explain how you calculated it, and explain the rationale for the methodology which you used.

RESPONSE

- a-c. No. The total revenue and revenue per piece calculations shown in my worksheet S-23 were calculated using the proposed rates and TYAR volume and weight projections. The total revenue used in the revenue per piece calculation is shown

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-52 (continued):

at the bottom of worksheet S-23 as the item labeled Adjusted Commercial Revenue. The revenue per piece is shown on the line below labeled Revenue Per Piece. It was calculated by dividing the Adjusted Commercial Revenue by the total Commercial TYAR volume.

This calculation, while not erroneous in itself, was erroneously used in discussions of the appropriate relationship between the average revenue per piece for Nonprofit subclass and Regular subclass mail. The following figures, calculated based on TYBR volumes and weights, should have been used for Regular subclass mail in those discussions.

Adjusted Commercial Revenue: \$12,922,618,579

Revenue Per Piece: \$0.2268

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-53. Please refer to USPS-LR-K-115, file USPST28Aspreadsheets.xls, worksheet 'S-24 TYAR Nonprofit Revenues.'

- a. In determining the revenue per piece for Standard Nonprofit Regular mail to be used as a basis for comparison with the revenue per piece of Standard (Commercial) Regular mail, when computing total revenues in the numerator, did you multiply the proposed rates for Standard Nonprofit Regular mail by TYBR billing determinants? If not, please state the billing determinants that you used, and explain the rationale for not using TYBR billing determinants. Also, for whatever billing determinants you used, please provide the total revenues that you used in the numerator of the revenue per piece computation for Standard Nonprofit Regular mail.
- b. Please provide the revenue per piece that you computed for Standard Nonprofit Regular mail, and state whether you divided the total revenues referred to in preceding part a by the TYBR volume of Standard Nonprofit Regular mail? If not, please state what volume figure you used in the denominator.
- c. If you did not calculate the revenue per piece of Standard Nonprofit Regular mail using TYBR billing determinants in both the numerator and denominator, please explain how you calculated it, and explain the rationale for the methodology which you used.
- d. In calculating the ratio of (i) the average revenue per piece of Standard Nonprofit Regular mail and (ii) the average revenue per piece of Standard (Commercial) Regular mail, did you use the average revenue per piece that in each instance was based on TYBR billing determinants and volumes? If not, please explain why not.

RESPONSE

- a-d. No. The total revenue, revenue per piece and revenue per piece ratio calculations shown in my worksheet S-24 were done using TYAR volumes and weights. Please also see my response to VP/USPS-T28-52. The total revenue and revenue per piece used in the ratio calculation are shown at the bottom of worksheet S-24 as the items labeled Adjusted Nonprofit Revenue and Revenue Per Piece. While the line items labeled Adjusted Nonprofit Revenue, Revenue Per Piece, and Revenue Per Piece Ratio are not in themselves erroneous, they were erroneously used in discussing the appropriate relationship between the average revenue per piece for Nonprofit subclass and Regular subclass mail. The following figures, calculated based on TYBR volumes and weights, should have been used for Nonprofit subclass mail in those discussions.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-53 (continued):

Adjusted Nonprofit Revenue: \$1,699,789,861

Revenue Per Piece: \$0.1376

Revenue Per Piece Ratio: 0.607.

As can be seen from the above figures, the ratio calculated using TYBR volume and weight data is not significantly different from the ratio in my workpaper S-24. The ratio calculated using TYBR data also rounds to the same whole number percentage, 61 percent, cited in my testimony.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-54. Please refer to USPS-LR-K-115, file USPST28Aspreadsheets.xls, worksheet 'ECR-22 TYAR Comm. Revenues.'

- a. In determining the revenue per piece for Standard (Commercial) ECR mail to be used as a basis for comparison with the revenue per piece of Standard Nonprofit ECR mail, when computing total revenues in the numerator, did you multiply the proposed rates for Standard (Commercial) ECR mail by TYBR billing determinants? If not, please state the billing determinants that you used, and explain the rationale for not using TYBR billing determinants. Also, for whatever billing determinants you used, please provide the total revenues that you used in the numerator of the revenue per piece computation for Standard (Commercial) ECR mail.
- b. Please provide the revenue per piece that you computed for Standard (Commercial) ECR mail, and state whether you divided the total revenues referred to in preceding part a by the TYBR volume of Standard (Commercial) ECR mail? If not, please state what volume figure you used in the denominator.
- c. If you did not calculate the revenue per piece of Standard (Commercial) ECR mail using TYBR billing determinants in both the numerator and denominator, please explain how you calculated it, and explain the rationale for the methodology which you used.

RESPONSE

a-c. No. The total revenue and revenue per piece calculations shown in my worksheet ECR-22 were calculated using the proposed rates and TYAR volume and weight projections. The total revenue used in the revenue per piece calculation is shown at the bottom of worksheet ECR-22 as the item labeled Adjusted Commercial Revenue. The revenue per piece is shown on the line below labeled Revenue Per Piece. It was calculated by dividing the Adjusted Commercial Revenue by the total Commercial TYAR volume.

This calculation, while not erroneous in itself, was erroneously used in discussions of the appropriate relationship between the average revenue per piece for Nonprofit ECR subclass and commercial ECR subclass mail. The following figures, calculated based on TYBR volumes and weights, should have been used for commercial ECR subclass mail in those discussions.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-54 (continued):

Adjusted Commercial Revenue: \$5,924,197,494

Revenue Per Piece: \$0.1777

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-55. Please refer to USPS-LR-K-115, file USPST28Aspreadsheets.xls, worksheet 'ECR-23 TYAR NP Revenues.'

- a. In determining the revenue per piece for Standard Nonprofit ECR mail to be used as a basis for comparison with the revenue per piece of Standard (Commercial) ECR mail, when computing total revenues in the numerator, did you multiply the proposed rates for Standard Nonprofit ECR mail by TYBR billing determinants? If not, please state the billing determinants that you used, and explain the rationale for not using TYBR billing determinants. Also, for whatever billing determinants you used, please provide the total revenues that you used in the numerator of the revenue per piece computation for Standard Nonprofit ECR mail.
- b. Please provide the revenue per piece that you computed for Standard Nonprofit ECR mail, and state whether you divided the total revenues referred to in preceding part a by the TYBR volume of Standard Nonprofit ECR mail? If not, please state what volume figure you used in the denominator.
- c. If you did not calculate the revenue per piece of Standard Nonprofit ECR mail using TYBR billing determinants in both the numerator and denominator, please explain how you calculated it, and explain the rationale for the methodology which you used.
- d. In calculating the ratio of (i) the average revenue per piece of Standard Nonprofit ECR mail and (ii) the average revenue per piece of Standard (Commercial) ECR mail, did you use the average revenue per piece that in each instance was based on TYBR billing determinants and volumes? If not, please explain why not.

RESPONSE

- a-d. No. The total revenue, revenue per piece and revenue per piece ratio calculations shown in my worksheet ECR-23 were done using TYAR volumes and weights. Please also see my response to VP/USPS-T28-54. The total revenue and revenue per piece used in the ratio calculation are shown at the bottom of worksheet ECR-23 as the items labeled Adjusted Nonprofit Revenue and Revenue Per Piece. While the line items labeled Adjusted Nonprofit Revenue, Revenue Per Piece, and Revenue Per Piece Ratio are not in themselves erroneous, they were erroneously used in discussing the appropriate relationship between the average revenue per piece for Nonprofit ECR subclass and commercial ECR subclass mail. The following figures, calculated based on TYBR volumes and weights, should have been used for Nonprofit ECR subclass mail in those discussions.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

RESPONSE to VP/USPS-T28-55 (continued):

Adjusted Nonprofit Revenue: \$312,412,288

Revenue Per Piece: \$0.0993

Revenue Per Piece Ratio: 0.558.

As can be seen from the above figures, the ratio calculated using TYBR volume and weight data is the same as the ratio in my workpaper ECR-23, and rounds to the same whole number percentage, 56 percent, cited in my testimony.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-56.

- a. If rates for Standard (Commercial) ECR mail increase by 5.6 percent, what must be the percentage increase in rates for Standard Nonprofit ECR mail in order to satisfy precisely a 60 percent relationship between the two?
- b. If rates for Standard (Commercial) ECR mail were to increase by 5.4 percent, what must be the percentage increase in rates for Standard Nonprofit ECR mail in order to satisfy precisely a 60 percent relationship between the two?
- c. If rates for Standard Nonprofit ECR mail increase by 5.9 percent, what must be the percentage increase in rates for Standard (Commercial) ECR mail in order to satisfy precisely a 60 percent relationship between the two?

RESPONSE

In responding to this question I am interpreting "rates for Standard (Commercial) ECR mail" to mean the average postage revenue per piece for this mail in the test year, and "rates for Standard Nonprofit ECR mail" to also mean the corresponding average postage revenue per piece.

- a. Since the TYBR ratio of the NECR revenue per piece to ECR revenue per piece is 56 percent, if ECR revenue per piece were to increase by 5.6 percent, NECR revenue per piece would have to increase by 13.9 percent to satisfy a precise 60 percent relationship between the two.
- b. If ECR revenue per piece were to increase by 5.4 percent, NECR revenue per piece would have to increase by 13.6 percent to satisfy a precise 60 percent relationship between the two.
- c. If NECR revenue per piece were to increase by 5.9 percent, ECR revenue per piece would have to decrease by 1.8 percent to satisfy a precise 60 percent relationship between the two.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-57. Please assume, for the purposes of this question, that the "as nearly as practicable" qualification to the 60 percent requirement of 39 U.S.C. § 3626(a)(6)(A) means as close as possible within the constraints of the following two factors only: (i) rounding; and (ii) charging rates at a mil level. Based on a 5.6 percent increase in Standard (Commercial) ECR mail, what percentage increase in the Standard Nonprofit ECR mail would be required?

RESPONSE

I have not performed this calculation, although it is my belief that the required increase would be similar to the more approximate estimate provided in response to VP/USPS-T28-56, subpart a.

RESPONSE OF UNITED STATES POSTAL SERVICE
WITNESS ALTAF H. TAUFIQUE TO INTERROGATORIES
OF VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.

VP/USPS-T28-58. Is it possible to structure the Standard (Commercial) ECR and Standard Nonprofit ECR subclass rates so that the entire Standard ECR subclass receives a 5.4 percent increase, and so that Standard Nonprofit ECR mail rates would be exactly 60 percent of commercial ECR rates? If so, what would be the percentage rate increases for Standard (Commercial) ECR and Standard Nonprofit ECR?

RESPONSE

I have not performed this calculation, although I believe that it would be mathematically possible to develop a set of rates that would meet the qualifications stated in the question if the tolerance were changed to "close to 60 percent," so that some deviation (less than one percentage point) was allowed. I do not believe that a practical set of rates could be achieved that would meet the 60 percent standard "exactly."

1 CHAIRMAN OMAS: At this point, I'm going to add
2 answers witness Taufique provided to the presiding officer's
3 information request. There are 14 answers which were not
4 designated.

5 They are as follows: POIR 2, Questions 4, 5, 7
6 and 15; POIR3, Questions 2, 3(a) and 4(b); POIR4, Questions
7 1, 2 and 4; POIR5, Questions 3, 4(b), 5 and 6; and finally,
8 POIR6, Questions 1 and 2.

9 Witness Taufique, would you answer those questions
10 to be the same as those you previously provided in writing?

11 THE WITNESS: Yes, sir. I would.

12 CHAIRMAN OMAS: I'm handing counsel to hand to the
13 reporter two copies of those answers and direct that they be
14 admitted into evidence and transcribed.

15 (The documents referred to,
16 previously identified as
17 Exhibit No. POIR2, Question 4,
18 were received in evidence.)
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RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 2, QUESTION 4

4. In the billing determinants for Standard Regular, there is a line item for Standard mail paid at First-Class/Priority rates. Please discuss what this represents. Why is this revenue assigned to Standard Regular rather than First-Class or Priority Mail?

RESPONSE:

Standard Mail has no single piece rates. A mail piece bearing Standard Mail markings that does not meet the eligibility requirements for any of the Standard Mail bulk rates is charged either the First-Class Mail single piece rate or Priority Mail rate, as applicable, depending on the weight of the piece. Often such pieces are residual pieces that are left over after all possible presorted bundles or containers are made up. Although these pieces pay the higher rate, they bear Standard Mail markings, are treated and counted as Standard Mail, and receive Standard Mail service. Since these pieces are treated as Standard Mail for all purposes except payment of postage, their revenue is counted as Standard Mail revenue.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 2, QUESTION 5

5. In the billing determinants for Standard Mail there is a line item entitled "barcode adjustment." Please discuss what this represents and provide workpapers showing how it is calculated.

RESPONSE:

Standard Mail Regular and Nonprofit machinable parcels bearing a correct parcel barcode for the delivery address ZIP Code are entitled to a three cent discount off the otherwise applicable rate. The Postal Service's Revenue, Pieces and Weight (RPW) reports do not distinguish between pieces that bear parcel barcodes and those that do not. Instead, a separate adjustment line showing the total amount of the parcel barcode discount for all pieces is reported. This line appears in the billing determinants as an offset to the total revenue. The number of parcel barcoded pieces can be calculated directly from this revenue adjustment by dividing the revenue adjustment by 0.03.

Thus, the barcode adjustment reported in the billing determinants is taken directly from a line in the RPW reports, and therefore, is not calculated in developing the billing determinants

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 2, QUESTION 7

7. Please reconcile the TYAR revenue figures for Periodicals within county, nonprofit and regular rate, and Standard Mail nonprofit and nonprofit ECR shown in Exhibit USPS-27B with the corresponding revenue figures presented in Exhibit USPS-28A, Table 12.

RESPONSE:

After Exhibit USPS-27B was developed, some pricing anomalies were discovered in the proposed rates for Standard Mail Nonprofit and Nonprofit ECR. As a result, the pound rates for Nonprofit DBMC piece-and-pound-rated pieces were adjusted upward by \$0.001 from \$0.510 to \$0.511 to ensure that the discount for Nonprofit DBMC pieces was the same for all four Standard Mail subclasses. The revenue impact was to raise Nonprofit TYAR revenues by \$37,632.

In addition, the pound rates for Nonprofit ECR DDU piece-and-pound-rated pieces were adjusted downward by \$0.001 from \$0.225 to \$0.224 to ensure that the discount was consistent with the discount in the other three subclasses. The revenue impact was to lower Nonprofit ECR TYAR revenues by \$7,479.

The net impact of these two changes was included in Exhibit USPS-28A, Table 12, but not in Exhibit USPS-27B.

For Periodicals, the TYAR revenue figure in Exhibit USPS-27B reflects a proposed Periodicals re-entry fee of \$40, instead of the \$45 fee actually proposed and reflected in Exhibit USPS-28A. See USPS-T-28 at 26 for an explanation of why the fee was proposed at \$45 instead of \$40.

Witness Robinson will be filing errata to reflect both of these changes in Exhibit USPS-27B.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 2, QUESTION 15

15. Refer to USPS LR-K-115, USPST28Cspreadsheets.xls, sheet SS-22 Money Orders. The volume and revenue of APO-FPO Money Orders are shown to be zero. Please explain why no APO-FPO Money Orders were sold in the base year, and why none are forecast to be sold in the test year. If APO-FPO Money Orders were sold in the base year, please provide the volume sold and the revenue from these sales. Please also provide the forecast volumes and revenues for the test year.

RESPONSE:

The reporting of the revenue for APO/FPO money orders was recently changed. Effective September, 2004, all APO/FPO money order revenues were included in the revenue account previously used for domestic money order revenues only. This change was not discovered until researching the answer for this question, when it was discovered that there were APO/FPO money orders sold in the Base Year.

The newly discovered data indicate that 367,301 APO/FPO money orders were sold in the Base Year, FY 2004 with an associated revenue of \$91,825. Because the Base Year billing determinant volume was adjusted to match the forecast volume (see Footnote 1 of LR-K-115, page 314, sheet SS-22), an adjusted Base Year volume of 376,929 was used to produce the forecast volume. Following are the forecast volumes and revenues for the Test Year, FY 2006

	Test Year Before Rates	Test Year After Rates
APO/FPO Volume	365,566	362,288
APO/FPO Revenue	\$91,391	\$90,572

Errata to the referenced spreadsheet will be filed shortly.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

2. The unit savings in mail processing and delivery costs for Periodicals mail are shown in Tables 2A and 2B and the methodology is shown in Table 2C. The unit delivery costs shown for Within County are from Docket No. R2001-1. (Please note that POIR No. 2, questions 1 and 8 concern unit delivery costs for Periodicals mail.) The proposed discounts and resulting passthroughs are shown in Table 2D. All costs reflect the Commission's methodology used in Docket No. R2001-1, as presented by the Postal Service in the current docket.

- a. Please confirm the mail processing, delivery, and total workshare unit costs; discounts; and percentage passthroughs in Tables 2A, 2B, and 2D. Please provide corrections as appropriate.
- b. Please explain fully the rationale for the calculations of the 3-digit and 5-digit automation letter cost savings. Please include in your explanation the reason for not simply using the difference between basic nonautomation and 3-digit and 5-digit automation letters as the basis for the discounts.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3
Revised: May 24, 2005**

**Table 2A
Outside County Mail Processing and Delivery Unit Savings**

	Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Presort Savings (In Cents)	
Basic Non-automation	28.070	10.689	38.759		[1]
3-Digit Non-automation	20.183	10.689	30.872	7.900	[2]
5-Digit Non-automation	14.438	10.689	25.127	5.700	[3]
Carrier Route	9.131	6.173	15.304	9.800	[4]

Source: MP USPS-K-102, p 34, Del USPS-K-101 Table 1 except CR (See note)

	Barcoded Letter-Size Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Automation Savings (In Cents)	
Non-automation Letters					
Basic	18.668	4.335	23.003	0.000	[5]
3/5 Digit	16.065	4.678	20.743	0.000	[6]
Automation Letters					
Basic	3.115	3.737	6.852	31.907	[7]
3-Digit	2.806	3.699	6.505	29.994	[8]
5-Digit	1.766	3.599	5.365	31.134	[9]

Source USPS-T-21, Table 2, USPS-LR-K-110, Table 1 (p 57), Table 1, USPS-K-101, Table 1

	Barcoded Flat Size Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Automation Savings (In Cents)	
Basic	26.289	9.795	36.084	2.676	[10]
3-Digit	19.345	9.795	29.140	1.733	[11]
5-Digit	13.878	9.795	23.673	1.455	[12]

Source MP USPS-K-102, p 34, Del USPS-K-101 Table 1

	Carrier Route Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Savings (In Cents)	
Basic Carrier Route	3.115	4.615	7.730	0.000	[13]
High Density	1.466	3.550	5.016	2.714	[14]
Saturation	1.466	3.049	4.515	3.215	[15]

Source: MP USPS-LR-K-107, Table 1, (Del See note)

Note: Carrier delivery costs are the subject of question 1 of POIR No. 2.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

**Table 2B
Within County Mail Processing and Delivery Unit Savings**

	Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Presort Savings (In Cents)	
Basic Nonautomation	28.070	10.689	38.759		[1]
3-Digit Nonautomation	20.183	10.689	30.872	7.900	[2]
5-Digit Nonautomation	14.438	10.689	25.127	5.700	[3]
Carrier Route	9.131	6.173	15.304	9.800	[4]

Source MP USPS-K-102, p 34, Del USPS-K-101 Table 1 except CR (See note)

	Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Automation Savings (In Cents)	
Barcoded Letter-Size					
Nonautomation Letters					
Basic	18.668	4.335	23.003	0.000	[5]
3/5-Digit	16.065	4.678	20.743	0.000	[6]
Automation Letters					
Basic	3.115	3.737	6.852	31.907	[7]
3-Digit	2.806	3.699	6.505	29.994	[8]
5-Digit	1.766	3.599	5.365	31.134	[9]

Source USPS-T-21, Table 2, USPS-LR-K-110, Table 1 (p 57), Table 1, USPS-K-101, Table 1

	Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Automation Savings (In Cents)	
Barcoded Flat Size					
Basic	26.289	9.795	36.084	2.676	[10]
3-Digit	19.345	9.795	29.140	1.733	[11]
5-Digit	13.878	9.795	23.673	1.455	[12]

Source MP USPS-K-102, p 34, Del USPS-K-101 Table 1

	Mail Processing (In Cents)	Delivery (In Cents)	Total (In Cents)	Savings (In Cents)	
Carrier Route					
Basic Carrier Route	3.115	4.615	7.730	0.000	[13]
High Density	1.466	3.550	5.016	2.714	[14]

Note Carrier delivery costs are the subject of question 8 of POIR No. 2.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

**Table 2C
Difference Calculations**

Basic Nonautomation	[1]
3-Digit Nonautomation	[2]
3-Digit Differential	[1] - [2]
3-Digit Nonautomation	[2]
5-Digit Nonautomation	[3]
5-Digit Differential	[2] - [3]
5-Digit Nonautomation	[3]
Carrier Route Nonautomation	[4]
Carrier Route Differential	[3] - [4]
Basic Nonautomation	[1]
Basic Automation Letters	[7]
Basic Automation Letter Differential	[1] - [7]
Basic Nonautomation	[1]
Basic Nonautomation Letters	[5]
3/5-Digit Nonautomation Letters	[6]
3-Digit Automation Letters	[8]
3-Digit Automation Letter Differential	([1] - [5]) + ([6] - [8])
Basic Nonautomation	[1]
Basic Nonautomation Letters	[5]
3/5-Digit Nonautomation Letters	[6]
5-Digit Automation Letters	[9]
5-Digit Automation Letter Differential	([1] - [5]) + ([6] - [9])
Basic Nonautomation	[1]
Basic Barcoded Flat	[10]
Basic Automation Flat Differential	[1] - [10]
3-Digit Nonautomation	[2]
3-Digit Barcoded Flat	[11]
3-Digit Automation Flat Differential	[2] - [11]
5-Digit Nonautomation	[3]
5-Digit Barcoded Flat	[12]
5-Digit Automation Flat Differential	[3] - [12]
Basic Carrier Route	[13]
High Density Carrier Route	[14]
High Density Carrier Route Differential	[13] - [14]
Basic Carrier Route	[13]
Saturation Carrier Route	[15]
Saturation Differential	[13] - [15]

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

**Table 2D
Periodicals Mail Unit Cost Avoidances and Passthroughs**

	Unit Avoidable Cost	Discount	% Pass- through
Basic Nonautomation	---	---	---
Basic Nonautomation Letter	31.907	9.700	30%
Basic Nonautomation Flat	2.676	5.000	187%
3-Digit Nonautomation	7.887	5.200	66%
3-Digit Nonautomation Letter	29.994	7.900	26%
3-Digit Nonautomation Flat	1.733	4.300	248%
5-Digit Nonautomation	5.745	12.300	214%
5-Digit Nonautomation Letter	31.134	6.400	21%
5-Digit Nonautomation Flat	1.455	3.200	220%
Carrier Route Basic \1	9.823	22.100	225%
Carrier Route High Density \1	3.138	3.400	108%
Carrier Route Saturation \1	3.714	5.400	145%
Wksharing Discnt Delivery Office Entry	2.750	1.800	65%
Wksharing Discnt SCF Entry	1.350	0.800	59%
Wksharing Discnt ADC Entry	0.290	0.200	69%
Wksharing Discnt Palletized Pieces	1.217	0.500	41%
Palletized Pieces Discount Destination Entry	1.200	1.600	133%

Within County

Basic Nonautomation	---	---	---
Basic Nonautomation Letter	31.907	5.275	17%
Basic Nonautomation Flat	2.676	2.700	101%
3-Digit Nonautomation	7.900	0.800	10%
3-Digit Nonautomation Letter	29.994	4.664	16%
3-Digit Nonautomation Flat	1.733	2.300	133%
5-Digit Nonautomation	5.700	1.000	18%
5-Digit Nonautomation Letter	31.134	3.900	13%
5-Digit Nonautomation Flat	1.455	1.900	131%
Carrier Route Basic \1	9.800	3.475	35%
Carrier Route High Density \2	2.714	1.525	56%
Carrier Route Saturation \2	3.215	2.125	66%
Worksharing Discount Delivery Office Entry	1.043	0.600	58%

\1 The unit delivery costs for these carrier route categories have not been verified. See POIR No. 2 question 1.

\2 The unit delivery costs for these carrier route categories are from Docket No. R2001-1 USPS-LR-J-107. See POIR No. 2 question 8.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3
Revised: May 24, 2005**

RESPONSE TO QUESTION 2:

a. Please see my response to POIR 3, Question 1. Table 2A, lines 1, 2, 3, 4, 10, 11, and 12 are confirmed. Lines 5, 6, 7, 8, 9, 13, 14, and 15 are not confirmed. See the attached Excel spreadsheet for the corrected numbers.

Lines 5 through 9 are not confirmed because of changes in the underlying cost study for mail processing cost. Errata will be filed shortly. Also, the MP source for Barcoded Flat Size Mail Processing should be page 35 instead of page 34.

Lines 13 through 15 should use the delivery cost numbers from POIR 2 Question 1. My comments for Table 2A also apply to Table 2B.

Table 2D Outside County. "Nonautomation" should be changed to "Automation" for lines 2, 3, 5, 6, 8, and 9. The Presort passthroughs are 66, 124 and 100 percent for 3-Digit, 5-Digit and Carrier Route respectively, instead of 26, 214 and 225 percents. The Automation Flats passthroughs are confirmed. The Automation Letters passthroughs are confirmed except for 5-Digit Automation letter, which should be 20 percent instead of 21 percent. The Carrier Route High Density and Saturation passthroughs are confirmed.

Though arithmetically correct, the dropship discounts for Destination Delivery Unit, SCF and ADC do not reflect the rate design that has been proposed by the Postal Service and recommended by the Commission in past dockets. The non-transportation (or handling) cost savings are generally divided evenly between the piece and pound rates. The true passthrough is 100 percent when this is taken into account, even though it appears as 50 percent passthrough on the piece side and a 50 percent passthrough on the pound side.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 2a (continued):

The Palletized pieces passthrough is confirmed. The Palletized pieces destination entry discount passthrough is not confirmed. The cost savings that accrue due to the dropshipment of editorial pounds are the basis for this discount. My response to POIR 10, question 1b in Docket No. R2001-1 discusses this issue. Tr. 14/5658-59. Here is the relevant portion of this response:

(b) There are no workpapers that estimate additional cost savings associated with the 1-cent dropship pallet discount (DMCS 421.49). But the dropship and pallet cost savings relied upon in my testimony provide a complete basis for the new 1-cent discount.

The original Postal Service proposal sought to provide dropship incentives by providing lower rates for editorial pounds entered at destinating facilities (DU, SCF and ADC), while maintaining a uniform editorial pound rate for all zones ranging from Zones 1 & 2 to Zone 8. The negotiated rate structure for the settlement rates instead provides a dropship pallet discount on the piece side of the rate schedule. Since virtually all dropship volume is palletized (USPS-T-34 at 17), this discount can be justified as another way to pass through some of the dropship cost savings underlying the original proposal. The original Postal Service proposal provides a discount worth \$22.2 million (LR-J-107, worksheet 'Pound Data_Ed.) for dropshipped editorial pounds based on a 50 percent passthrough of the transportation and non-transportation cost savings estimated for advertising pounds that are dropshipped. Using a still modest passthrough of 75 percent, the value of the editorial pound rate discount would be roughly equal to the value of the 1-cent discount (DMCS 421.49) on the approximately 3.3 billion palletized and dropshipped pieces.

Additional support for this discount can be provided by looking at the cost savings associated with

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 2a (continued):

palletization. As shown by witness Schenk, the cost savings for palletized pieces compared to pieces in sacks is 2.09 cents. USPS-T-43 at 6. The original pallet discount of 0.5 cents per piece is based on a small passthrough of this cost saving. An approximately 72 percent passthrough of the cost savings of 2.09 cents would lead to a 1.5 cent discount for palletized pieces.

Table 2D Within County. The two lines under Basic Nonautomation should be changed to Basic Automation Letters and Basic Automation Flats, instead of Basic Nonautomation Letters and Basic Nonautomation Flats. Similar changes should be made for the two lines under 3-Digit Nonautomation and 5-Digit Nonautomation. I estimate presort pass-throughs of 10, 17 and 36 percent, respectively, for the 3-Digit, 5-Digit and Basic Carrier Route rates, instead of 10, 18 and 35 percents. The Automation Flats passthroughs are confirmed. I estimate Automation Letters passthroughs of 17, 15, and 12 percent for Basic, 3-Digit, and 5-Digit Automation Letters, respectively, instead of the 17, 16 and 13 percent passthroughs provided in Table 2D. The Carrier Route High Density and Saturation passthroughs are estimated to be 48 and 57 percent, respectively, instead of 56 and 66 percent. I am not able to derive the passthroughs for the Delivery Office Entry discount. In a traditional rate case, this discount and the delivery unit pound rate receive some allocation of non-transportation cost avoidance and these allocations have not been done in this docket.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 2 (continued):

b. It is my understanding that the methodology used to calculate the 3-digit and 5-digit automation letter cost unit savings has been used by Postal Service for the past three cases, and that this methodology was approved and relied upon by the Postal Rate Commission.

The Postal Service and the Commission have taken into account shape as well as automation differences in calculating the cost savings for Periodicals automation letters. The Postal Service's proposal in Docket No. R2001-1 estimated the difference between nonautomation flats (assuming that the nonautomation rate categories are overwhelmingly flats) to nonautomation letters at roughly the same presort level, and then added the difference between nonautomation letters and automation letters at a similar presort level. The method proposed in the question takes the difference between nonautomation flats and automation letters without taking into account the presort differences.

Attachment to POIR3

Question 2

Outside County Periodicals

**Calculation of High Density & Saturation Passthroughs
Cost Avoidances**

Carrier Route	Mail Processing	Delivery ¹	Total	Savings
	(In Cents)	(In Cents)	(In Cents)	(In Cents)
Basic Carrier Route	3.115	6.173	9.288	
High Density	1.466	4.684	6.15	3.138
Saturation	1.466	4.108	5.574	3.714

¹ See witness John Kelly's response to POIR2 Question 1

Rates

	Rates	Discounts	Pass-throughs
Basic Carrier Route	17.2		
High Density	13.8	3.4	108%
Saturation	11.8	5.4	145%

Attachment to POIR3
Question 2
Within County Periodicals

**Calculation of Presort Passthroughs
Cost Avoidances**

	Mail Processing (In Cents)	Delivery (In cents)	Total (In cents)	Presort Savings (In cents)
Basic Nonautomation	28.070	10.689	38.759	
3-Digit Nonautomation	20.183	10.689	30.872	7.887
5-Digit Nonautomation	14.438	10.689	25.127	5.745
Carrier Route	9.131	6.173	15.304	9.823

Rates

	Rates	Discounts	Pass-throughs
Basic Nonautomation	10.000		
3-Digit	9.200	0.800	10%
5-digit	8.200	1.000	17%
Carrier Route	4.700	3.500	36%

**Calculation of Automation Passthroughs
Cost Avoidances**

Flats	Barcoded Flat Size Mail Processing (In Cents)	Delivery (In cents)	Total (In cents)	Automation Savings (In cents)
Basic	26.289	9.795	36.084	2.675
3-Digit	19.345	9.795	29.140	1.732
5-Digit	13.878	9.795	23.673	1.454

Rates

	Rates	Discounts	Pass-throughs
Basic Automation Flats	7.3	2.700	101%
3-Digit Automation Flats	6.9	2.300	133%
5-Digit Automation Flats	6.3	1.900	131%

Letters

Nonautomation Letters				
Basic	13.548	4.335	17.883	
3/5 Digit	11.719	4.678	16.398	
Automation Letters				
Basic	3.165	3.737	6.902	31.857
3-Digit	2.857	3.699	6.556	30.718
5-Digit	1.819	3.599	5.418	31.856

Rates

	Rates	Discounts	Pass-throughs
Basic Auto Letters	4.7	5.300	17%
3-Digit Auto Letters	4.5	4.700	15%
5-Digit Auto Letters	4.3	3.900	12%

**Calculation of High Density & Saturation Passthroughs
Cost Avoidances**

	Carrier Route			
	Mail Processing	Delivery¹	Total	Savings
	(In Cents)	(In Cents)	(In Cents)	(In Cents)
Basic Carrier Route	3.115	6.173	9.288	
High Density	1.466	4.684	6.15	3.138
Saturation	1.466	4.108	5.574	3.714

¹ See witness John Kelly's response to POIR2 Question 1

	Rates		
	Rates	Discounts	Pass-throughs
Basic Carrier Route	4.7		
High Density	3.2	1.5	48%
Saturation	2.6	2.1	57%

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

3. Tables 3A to 3E show the development of passthrough percentages for all Standard Mail discounts based on the Postal Service's proposed rates. Tables 3A to 3D show the avoidable mail processing and delivery costs. Table 3E shows the avoidable cross docking and transportation cost. All costs reflect the Commission's methodology used in Docket No. R2001-1, as presented by the Postal Service in the current docket.

- a. Please confirm the mail processing, delivery, crossdocking, transportation, and total workshare unit costs; discounts; and percentage passthroughs in Tables 3A to 3E. Please provide corrections as appropriate.

RESPONSE:

a. I can confirm that the Mail Processing Unit Costs, Delivery Unit Costs, calculated totals of Mail Processing Unit Costs and Delivery Unit Costs and the differentials of these totals, the calculated effective discounts and the Percentage Passthroughs are correct as shown on Tables 3C and 3D, with the following exceptions and qualifications:

- Row 10, column 2, the value should be 6.173 (Source: USPS-LR-K-101.xls, Summary TY, Cell O103).
- Row 11, column 2, the value should be 4.684 (Source: USPS-LR-K-101.xls, Summary TY, Cell O104).
- Row 13, column 2, the value should be 4.684 (Source: USPS-LR-K-101.xls, Summary TY, Cell O104).
- Row 14, column 2, the source should be: USPS-LR-K-101.xls, Summary TY, Cell O105.
- Row 16, column 2, the value should be 6.173 (Source: USPS-LR-K-101.xls, Summary TY, Cell O103).
- Row 19, column 2, the value should be 4.684 (Source: USPS-LR-K-101.xls, Summary TY, Cell O104).
- Row 22, column 2, the source should be: USPS-LR-K-101.xls, Summary TY, Cell O105.

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 3a (continued):

- Row 10, column 3, the value should be 9.396;
- Row 11, column 3, the value should be 6.164;
- Row 12, column 3, the value should be 3.232;
- Row 12, column 4, the value should be 80%;
- Row 13, column 3, the value should be 6.164;
- Row 15, column 3, the value should be 0.576;
- Row 15, column 4, the value should be 156%;
- Row 16, column 3, the value should be 9.396;
- Row 18, column 3, the value should be -3.729;
- Row 18, column 4, the value should be 0%;
- Row 19, column 3, the value should be 6.164;
- Row 21, column 3, the value should be 0.672;
- Row 21, column 4, the value should be 74%;

I can confirm the same quantities and calculations for Tables 3A and 3B

with the following qualifications:

- The Standard Mail flats figures listed under column (1) "Mail Processing Unit Cost" on lines 4-5 are correct for the "worksharing related unit cost" portions of the total actual mail processing unit cost estimates.
- The figures supporting the letter/flat cost differentials on lines 7 and 10 are correct and represent total mail processing unit cost estimates for

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 3a (continued):

those rate categories. The citation for line 7, however, is incorrect. It should read "LR-K-102, p. 69, Col. 13, G33."

- For the automation presort rate categories, lines 13, 14, 16, and 17, the numbers are correct and reflect the presort-adjusted mail processing unit cost estimates.
- The source listed on line 8, column (2) is incorrect. It should be LR-K-110, p. 57, Col. 3, G13.
- Row 1, column 1, the value should be 13.548;
- Row 2, column 1, the value should be 11.719;
- Row 8, column 1, the value should be 18.665;
- Row 11, column 1, the value should be 16.071;
- Row 19, column 1, the value should be 13.548;
- Row 20, column 1, the value should be 4.022; the source should be LR-K-110, p. 57, Col 2, E23.
- Row 22, column 1, the value should be 4.022; the source should be LR-K-110, p. 57, Col 2, E23;
- Row 23, column 1, the value should be 3.165;
- Row 25, column 1, the value should be 11.719;
- Row 26, column 1, the value should be 2.857;
- Row 28, column 1, the value should be 2.857;
- Row 29, column 1, the value should be 1.819;
- Row 1, column 3, the value should be 17.883;
- Row 2, column 3, the value should be 16.397;

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 3a (continued):

- Row 3, column 3, the value should be 1.486;
- Row 8, column 3, the value should be 23;
- Row 9, column 3, the value should be 13.263;
- Row 11, column 3, the value should be 20.749;
- Row 12, column 3, the value should be 4.065;
- Row 19, column 3, the value should be 17.883;
- Row 20, column 3, the value should be 7.843;
- Row 21, column 3, the value should be 10.04;
- Row 21, column 5, the value should be 51%;
- Row 22, column 3, the value should be 7.843;
- Row 23, column 3, the value should be 6.902;
- Row 24, column 3, the value should be 0.941;
- Row 25, column 3, the value should be 16.397;
- Row 26, column 3, the value should be 6.556;
- Row 27, column 3, the value should be 9.841;
- Row 27, column 5, the value should be 48%;
- Row 28, column 3, the value should be 6.556;
- Row 29, column 3, the value should be 5.418;
- Row 30, column 3, the value should be 1.138;

I cannot confirm Table 3E in its entirety. The values for column (2),
Crossdocking Costs, for DBMC and DDU appear to have been switched. The

**RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO PRESIDING OFFICER'S INFORMATION REQUEST NO. 3**

Revised: May 24, 2005

Response to Question 3a (continued):

values in column (2) have also been revised slightly. A corrected version of Table 3E is attached to this response, and I can confirm the values and calculations shown on the corrected Table 3E with the following qualifications:

- The "Per Piece" Avoidable Costs shown in column (4) are developed by pro-rating the per-pound avoidable costs to a 3.3 ounce piece. They do not necessarily represent the true or measured avoidable costs for a piece of this weight, which is unknown. Neither do these avoidable costs represent the true or measured avoidable costs for an average-weight piece-rated piece.

The descriptions of the quantities in columns (4) to (8) of the original Table 3E are potentially misleading and should be revised as shown in the corrected Table 3E

POIR 3, Question 3a

Revised Table 3E

Docket No. R2005-1
Dropship Avoidable Costs, Proposed Discounts, and Passthroughs
Standard Mail
(Amounts in Cents)

	<u>Avoidable Cost per Pound</u>			<u>Pro-Rated</u>	<u>Proposed Discounts</u>			
	Transportation	Crossdocking	Total	Avoidable Cost per Piece (Piece-Rated Pieces Only)	Per Pound (Pound-Rated Pieces Only)	Per Piece (Piece-Rated Pieces Only)	Per Pound (Pound-Rated Pieces Only)	Per Piece (Piece-Rated Pieces Only)
	(1)	(2)	(3)=(1)+(2)	(4)	(5)	(6)	(7)=(5)/(3)	(8)=(6)/(4)
1 DBMC	10.96	2.36	13.32	2.75	10.5	2.2	78.8%	80.1%
2 DSCF	13.09	4.29	17.38	3.58	13.2	2.7	76.0%	75.3%
3 DDU	15.41	5.70	15.41	3.18	16.6	3.3	107.7%	103.8%

Source: Col. 1 from USPS-LR-K-112, Excel File: AppenBPRC, Sheet: Results, Cells F43, F42 and F41

Col. 2 from USPS-LR-K-112, Excel File: AppenCPRC, Sheet: Results, Cells E43, E42, and E41

Col. 4 = Col. 3 * 3.3 ounces/16 ounces (Per-Pound Avoidable Cost prorated to 3.3 ounces)

Col. 5 & 6 discounts are calculated using the proposed rates shown in Exhibit USPS-28A, pp. 16-19 of 65.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 3, QUESTION 4(b)

4. Tables 4A, 4B, and 4C depict the calculated passthroughs, using the PRC costing methodology reflected in Docket No. R2001-1, for Parcel Post, Bound Printed Matter (BPM), and Media Mail/Library Rate (Media), respectively. The passthroughs were calculated using the avoided costs found in the Postal Service's version of PRC Parcel cost models, USPS-LR-K-103.

- (b) Please provide cost avoidance calculations, using the PRC methodology reflected in Docket No. R2001-1, for Parcel Return Service (PRS) mail, and provide the calculated passthroughs for PRS.

RESPONSE:

A fuller explanation of the way we treated PRS should have been provided in my original testimony. The following discussion should remedy that omission.

Since PRS volumes, revenues and costs are included in the Base Year totals, PRS had to be addressed one way or another in the Postal Service's Test Year projections. The PRS experiment will expire less than three weeks into the Test Year. At present, the Postal Service is still collecting and evaluating data from the experiment and I am informed that the Postal Service has made no decision on whether to request an extension of the experiment and file for a permanent classification or not. With that background, the Postal Service faced several possible treatments for PRS:

- The Postal Service could have eliminated PRS volumes, costs and revenues from Test Year projections. But this could have unnecessarily alarmed PRS customers, who might have viewed it as demonstrating a lack of commitment to PRS on the Postal Service's part.
- The Postal Service could have assumed that PRS would continue into the Test Year at its current rates. This treatment would have effectively increased the PRS discounts significantly. In turn, this could have led the Commission and other interested parties (for example, our Package

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 3, QUESTION 4(b)

Services competitors) to question whether the Postal Service was intentionally using the current rate case to increase the discounts more than proportionately without offering any cost studies or other demonstrations that such increases were appropriate.

- The Postal Service could project PRS revenues into the Test Year assuming PRS rates were increased by the uniform 5.4% increase that other mail services received. In the end, this choice was the most appealing, since it represented the most neutral pricing assumption and had the least potential to send out false signals regarding the Postal Service's intentions.

As I noted previously, the PRS experiment will expire in October of 2005. The Postal Service must request a permanent classification for PRS before then to keep the experiment running. I am informed that the Postal Service is still in the data collection phase of the experiment and has not done any new cost studies. It will soon begin evaluating the information it has been collecting and expects to have sufficient analyses completed in time to determine the best course of action before the term of the experiment expires.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 4, QUESTION 1

1. Please confirm that in FY 2004 there was no volume in any weight increment for the rate category Parcel Post DBMC zone 5. If confirmed, please discuss what factors lead to the disappearance of this volume.

RESPONSE:

Not confirmed. The PERMIT system reported approximately 39,000 DBMC Zone 5 pieces in FY 2004, so there was at least some volume that year. However, the Parcel Post weight distribution study, which is used to distribute destination-entered pieces to rate cells, did not detect a statistically significant level of Zone 5 pieces. Therefore, when this study was used to distribute overall volume to the weight/zone cell, there appears to be no volume in Zone 5. To the extent that some actual Zone 5 volume is effectively distributed to other zones by using this weight distribution study, the revenue impact is accounted for in the Revenue Adjustment Factor. Due to the apparent low volume affected (by virtue of the low 39,000 figure from PERMIT), this distribution method does not significantly affect Parcel Post rate design or revenue calculation.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 4, QUESTION 2

2. In past cases, an adjustment was made to Parcel Post revenue for OMAS mail. In this case no adjustment was made. Please explain the rationale for not making an OMAS adjustment.

RESPONSE:

In past cases, we have reported OMAS mail revenue as a separate data component in the RPW. However, no separate line item for OMAS mail has been reported in the RPW since FY 2003. Data regarding OMAS have been merged with Intra and Inter BMC mail through the PERMIT system and Postal One.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 4, QUESTION 4

4. In October 2003, the experimental Parcel Return Service (PRS) began. This service allows shippers to retrieve customer return mail from an identified BMC or DDU. With regard to this service:

- (a) Has a separate cube-weight relationship been developed for PRS mail? If not, which Parcel Post category best reflects the cube-weight relationship of PRS mail? Please discuss.
- (b) Are separate transportation costs developed for PRS mail? If not, why not?
- (c) Has the unit cost of PRS mail been modeled? If not, why not?
- (d) Please explain why the TYBR volume estimate in USPS-T-28 B Spreadsheets for PRS mail does not include any parcels subject to either the oversize rate or the balloon rate.

RESPONSE:

(a) No separate cube-weight relationship has been developed for the experimental PRS. The Parcel Select category best reflects the cube-weight relationship of PRS mail.

As discussed in witness Kiefer's testimony (MC2^o03-2, USPS-T-3 at page 9, footnote 3). RBMC pieces were expected to be most directly comparable to Parcel Select pieces.

(b) No separate transportation cost was developed for PRS mail. However, estimates of transportation cost savings were developed by witness Eggleston (MC2003-2, USPS-T-2) for purposes of the experiment. Please see response to POIR NO. 3, question 4.

(c) The unit cost of PRS mail has not been modeled. Please see response to POIR NO. 3, question 4.

(d) In order to project revenue for PRS in the test year (see response to POIR No. 3, Question 4), an assumption was made regarding the volume profile of PRS pieces. Although no full year of "billing determinant" information was available, there was a volume profile from the early months of the experiment. Information from that time

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 4, QUESTION 4

period showed no oversized or balloon parcels, hence there was no test year projection of revenue in these categories. It is not expected that these categories will contain significant volume, so the simplifying assumption used to project TYBR revenues has only a minor potential impact on the revenue projections.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 5, QUESTION 3

3. The following questions are regarding Priority Mail. Please refer to R2005-1, USPS-T-28A spreadsheets and R2001-1, LR-J-103. In R2001-1, there was no separate line item in the rate calculation worksheets for the balloon volume (packages weighing less than 10 pounds but measuring more than 84 inches in length and girth combined). In R2005-1, in the USPS-T-28A spreadsheets, the balloon mail is a separate line item.

- (a) In R2001-1, was all the balloon volume allocated to the 15 lbs. category or was it spread out among weight increments? Please explain.
- (b) Please explain why the balloon mail was separated from the rest of Priority in R2005-1 and not in R2001-1.
- (c) In R2005-1, what are the attributable costs associated with the balloon mail and how should they be distributed? Please break the attributable costs for the balloon mail into per-piece costs and per-pound costs using the method applied to the rest of Priority Mail in R2001-1, LR-J-103.
- (d) Have there ever been studies done to determine the extra costs associated with balloon mail? If yes, please provide the latest data.
- (e) The FY 2004 volume for the 14 lbs. category is 1,018,938, for the 15 lbs. category is 490,904, and for the 16 lbs. category is 710,184. Please explain the considerably lower volume in the 15 lbs. category compared with both the 14 lbs. and 16 lbs. categories.

RESPONSE:

First, for clarification, the balloon rate does not apply to "packages weighing less than 10 pounds but measuring more than 84 inches in length and girth combined."

According to DMM Section 101.5.3, the balloon rate applies to Priority Mail "items weighing less than *15 pounds* but measuring more than 84 inches in combined length and girth" (italics added).

However, ODIS-RPW does not consider parcels weighing more than 14 pounds, up to 15 pounds, to be balloon-rated, even if they do exceed 84 inches in combined length and girth. That is because regardless of their dimensions, such parcels would pay the 15-pound rate anyway.

- (a) The RPW data system did not separately identify Priority Mail balloon-rated parcels until FY 2002. Docket No. R2001-1, which relied upon a FY 2000 Base Year,

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 5, QUESTION 3

predated this change. As a result, balloon-rated volume was by default distributed to the weight increments according to actual weight.

This had a limited effect on revenue, though, because RPW revenue was based on evident postage – that is, the postage actually applied as evidenced by the indicia. For stamped and metered balloon-rated parcels, evident postage reflected the actual balloon rate paid, not the weight increment to which the parcel was distributed. The effect, therefore, of distributing such parcels to weight increments in the 1-14 pound range was not to lower total RPW revenue, but to increase the revenue adjustment factor applied to “calculated revenue” (see LR-J-103, Attachment A, Page 3). Postage paid is not evident, on the other hand, for permit-imprint mail pieces. For such pieces that were balloon-rated, RPW revenue was based on actual weight (ranging up to 14 pounds) and was therefore understated.

(b) Since FY 2002 (as reflected in the Priority Mail Billing Determinants), the RPW (now ODIS-RPW) data system has been able to separately identify Priority Mail balloon-rated parcels. The Docket No. R2005-1 Base Year and Test Year volume distributions, which isolate the balloon-rate category, reflect this improvement.

(c) Attributable costs are estimated for mail subclasses but not for rate categories such as the Priority Mail balloon rate.

The per-piece and per-pound cost elements appearing at the top of LR-J-103, Attachment F, Page 1 in Docket No. R2001-1, result from volume-variable cost distributions for the purpose of rate design. These cost elements apply generally to all

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 5, QUESTION 3

Priority Mail and not specifically to any one rate category. Further below in the table, allocated unit costs are derived, by weight increment and by zone, from the cost elements. It is not possible to derive similar allocated unit costs for balloon-rated parcels because contemporaneous weight data were not available from the RPW data system (please see the response to Part "a" above).

(d) No such studies have been completed. However, the Postal Service is currently conducting a substantive review of the relationship between parcel size and cost. Balloon-rated parcels are one subject of this review.

(e) The 490,904 pieces shown at 15 pounds is the result of an ODIS-RPW edit-program error. A total of 405,460 parcels were misidentified as balloon-rated rather than weight-rated. This error was found only after the Docket No. R2005-1 filing was well underway, and because it was determined that the effects are minimal (see below), it was decided that the volume distribution would not be revised. A revision would have the following effects on USPS-T-28A, PM-1, Page 1: the number of balloon-rated parcels decreases by 405,460 (to 90,409); the number of 15-pound pieces increases by 392,685 (to 883,589), and total volume at all other weight levels, combined, increases by 12,775. Total volume stays the same at 848,633,083.

Base Year RPW revenue remains unchanged at \$4,419,822,668 (excluding pickup fees). However, "calculated revenue" at USPS-T-28A, PM-1, Page 3 declines by about -\$151,000, requiring a slight increase in the "revenue adjustment factor" from 100.869 percent to 100.873 percent in order to match the unchanged RPW total.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 5, QUESTION 3

The Postal Service considers these changes to be de minimis. Not only do total volume and revenue not change, but the volume shift (405,460 pieces) represents less than 0.05 percent of all Priority Mail volume. Moreover, there are no implications for the Priority Mail rates proposed by witness Taufique in USPS-T-28.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 5, QUESTION 4(b)

4. Please answer the following questions regarding Priority Mail. In R2001-1, USPS-LR-J-96, page 13 contained weight and the average haul by zone for Commercial Air and Other Air in the base year. Please refer to R2001-1, LR-J-103 Per-Pound Elements worksheet. Weight and the average haul by zone for Commercial Air and Other Air was used to distribute distance-related and nondistance-related air transportation costs to the zones. More specifically, total air pounds is used to distribute nondistance-related air costs to the zones and passenger pound miles is used to distribute distance-related air transportation costs to the zones. R2005-1, USPS-LR-K-37, contains weight and the average haul by zone for FedEx and Other Air.

- (b) FedEx costs are incurred based on cubic feet rather than weight. Can one reasonably allocate FedEx transportation costs to the weight categories and zones? If so, how should that be done?

RESPONSE:

(b) The reasonability of such an allocation depends ultimately on the relationship between weight and FedEx "cube," as well as the ability to measure that relationship. The Postal Service is currently studying this matter as part of the substantive review mentioned in the response to Question 3d above.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 5, QUESTION 5

5. Please refer to the footnote on page 2 of the Per-Pound Elements worksheet LR-J-103 in R2001-1, which states "Local share (12.35%) established in R90-1."

- (a) Was there a study conducted to arrive at that local share percentage? If yes, please give a detailed summary of that report. If not, please explain how local share was determined.
- (b) Have there been any recent studies that confirm the percentage of local share is still valid? If yes, please give details. If not, please explain why 12.35% is reasonable.

RESPONSE:

(a) The 12.35 percent Local share (of total Local and Zone 1-3 postage pounds) in Docket No. R90-1 derived from a Local/non-Local split that was available, at the time, through an algorithm in the RPW data system.

(b) The referenced systems capability in part "a" above was lost sometime in the early 1990s when the TRACS system – which superseded RPW in some respects – was introduced. No comparable calculation has been made since Docket No. R90-1, and neither ODIS-RPW nor TRACS presently have the capability to distinguish Local from non-Local volume (or weight). In the absence of a better number, we continue to rely on the 12.35 percent figure. The Postal Service will endeavor to examine possible solutions for updating the figure in the future.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE TO
POIR NO. 5, QUESTION 6

6. Please provide the average weight per piece (in pounds) in the base year for the flat-rate envelope in Priority Mail.

RESPONSE:

Average weight for the Priority Mail flat-rate envelope in the Base Year (FY 2004) was
0.752 pounds.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 1

1. Please confirm that in Fee Schedule 1000, Miscellaneous Fees, Attachment A, page 83 of the Postal Service Request, the line identifying current and proposed fees for a Periodicals Original Entry application should read as follows:

	Current	Proposed
Periodicals		
A. Original Entry	375.00	395.00

RESPONSE:

Confirmed, consistent with page 56 of my Exhibit A.

RESPONSE OF POSTAL SERVICE WITNESS TAUFIQUE
TO POIR NO. 6, QUESTION 2

2. Please provide Base Year volume by zone and weight group for the three categories of Express Mail (Post Office to Post Office, Post Office to Addressee, Custom Designed). Also, please provide the weight adjustment factor used to conform weight estimates to the EMRS reported weight and an explanation of how that factor is determined.

RESPONSE:

As requested, the Base Year volume by zone and weight group for the three categories of Express Mail (Post Office to Post Office, Post Office to Addressee, and Custom Designed) is provided below, and is also provided in the attached Excel spreadsheet.

The weight adjustment factor used to conform the weight estimates from the Billing Determinants Base Year volume by zone and weight to the EMRS reported weight adjustment factor is 21606073. The calculation of this factor is described in the next paragraph

Although volume and revenue data are available in detail from EMRS, the only weight information is the thresholds between the Weight Steps. To determine the average weight of the pieces within a Weight Step for the three categories of Express Mail (Post Office to Post Office, Post Office to Addressee, and Custom Designed), an iterative process is used to determine the necessary "Weight Range Adjustment Factor" that describes the average weight of pieces within a weight step. A technique within Excel known as "Goal Seek" is used to calculate the adjustment needed for each weight step and applied by zone. The goal is the 46,200,097 pounds that have to be distributed by weight steps and to all zones. The Flat Rate weight (4,424,236) is excluded from the Express Mail weight (50,624,333) as reported in the Revenue, Pieces, and Weight (RPW) File, resulting in a net weight of 46,200,097. "Goal Seek" utilizes this amount to determine the adjustment needed for each Weight Step to derive the average weight for each Weight Step. The Weight for each zone in the Weight Step is this average weight times the number of pieces in the Zone, from EMRS volume data. The final result sums to the weight of 46,200,097.

**EXPRESS MAIL VOLUME BY ZONE AND WEIGHT CLASS 1/
BASE YEAR - GFY 2004**

Weight Class		Zone 1	Zone 2	Zone 3	Zone 4	Zone 5	Zone 6	Zone 7	Zone 8	Zone 9	Total
A Labels (PO to PO)											
0	0.5		2 492	2 291	2 040	1 531	3 013	332	324	109	12 132
0.5	1		1 750	555	649	403	1 130	222	291	253	5 253
1	2		2 334	1 300	707	727	1 786	328	165	347	7 694
2	3		1 389	1 147	572	638	1 514	222	98	182	5 762
3	4		918	797	619	963	1 591	347	162	133	5 530
4	5		492	455	604	703	1 276	322	138	130	4 120
5	6		451	305	494	587	1 135	245	123	162	3 502
6	7		284	158	447	454	863	179	101	140	2 626
7	8		179	171	303	409	677	109	83	130	2 061
8	9		123	83	267	338	555	85	68	108	1 627
9	10		69	48	224	367	511	70	47	92	1 428
10	11		86	49	164	326	464	71	57	82	1 299
11	12		82	166	145	234	481	50	44	77	1 279
12	13		96	28	120	204	390	29	27	61	955
13	14		71	50	89	186	364	22	48	56	886
14	15		69	41	78	145	348	29	58	40	808
15	16		54	30	77	157	396	21	45	44	824
16	17		30	29	64	159	421	16	71	30	820
17	18		27	31	36	127	335	20	49	50	675
18	19		26	12	51	115	268	15	23	31	541
19	20		15	9	37	97	187	19	36	29	430
20	21		18	10	58	109	119	15	26	25	380
21	22		18	18	46	111	130	20	43	26	412
22	23		22	14	39	113	133	18	19	17	375
23	24		9	16	40	82	186	15	13	10	371
24	25		9	20	44	119	164	16	14	8	396
25	26		17	18	52	87	196	28	20	5	423
26	27		12	19	68	109	223	45	20	8	504
27	28		11	11	91	107	290	84	26	10	630
28	29		5	12	71	97	301	66	8	12	572
29	30		8	21	69	91	269	47	17	11	533
30	31		9	13	62	96	208	30	11	8	437
31	32		12	25	38	84	164	24	19	17	383
32	33		6	13	53	91	154	12	14	13	356
33	34		12	12	30	58	109	22	19	13	275
34	35		7	12	22	63	99	15	13	17	248
35	36		18	7	27	50	89	13	18	12	234
36	37		6	8	27	56	78	10	20	4	209
37	38		7	9	25	54	75	7	12	13	202
38	39		9	10	20	44	62	10	13	7	175
39	40		7	6	20	51	89	11	24	14	222
40	41		3	1	37	55	66	6	29	21	218
41	42		8	6	17	39	89	9	32	16	216
42	43		3	2	13	46	81	13	20	8	186
43	44		9	10	24	47	90	14	21	11	226
44	45		5	0	15	64	84	10	19	7	204
45	46		0	6	21	50	85	4	11	22	199
46	47		5	6	14	41	72	2	12	10	162
47	48		3	5	8	43	63	9	22	15	168
48	49		2	6	13	38	74	6	18	17	174
49	50		14	5	18	56	57	5	20	18	193
50	51		6	4	17	51	54	5	26	9	172
51	52		11	1	9	39	46	6	22	21	155
52	53		2	6	10	78	56	6	16	20	194
53	54		2	3	17	59	55	1	24	11	172
54	55		1	3	17	50	27	4	19	20	141
55	56		6	2	10	53	37	8	21	22	159
56	57		0	1	12	41	48	5	24	19	150
57	58		5	1	13	57	50	7	21	22	176
58	59		3	1	11	46	37	4	17	23	142
59	60		3	0	25	53	50	7	34	26	198
60	61		0	2	10	47	51	2	24	21	157
61	62		3	0	12	34	61	6	28	22	166
62	63		2	1	7	31	34	5	27	16	123
63	64		0	0	5	16	21	3	10	8	63
64	65		1	2	1	13	9	1	4	3	34
65	66		0	0	2	6	1	0	3	0	12
66	67		1	0	2	5	1	1	0	2	12
67	68		1	0	1	6	4	1	0	0	13
68	69		0	0	0	3	1	0	1	0	5
69	70		3	0	1	0	1	0	0	2	7
Total			11 362	8 103	9 051	11 709	22 248	3 413	2 952	2 948	71 786

B Labels (PO to Addressee)

0	0.5	9 820 109	5 481 986	7 183 980	7 562 553	4 803 482	2 933 173	2 906 083	1 766 440	42 457 806
0.5	1	1 201 629	546 025	636 877	639 938	443 390	269 848	319 094	248 089	4 304 890
1	2	750 828	381 573	466 582	491 043	326 008	220 924	239 004	196 581	3 072 543
2	3	270 034	154 716	194 842	207 335	150 516	105 856	112 147	98 357	1 293 803
3	4	135 316	86 669	113 778	124 007	90 789	68 367	68 585	61 352	748 863
4	5	80 305	52 830	72 870	81 303	60 393	48 476	46 310	41 512	483 999
5	6	50 220	34 548	48 137	54 650	41 227	34 115	31 598	28 791	323 286
6	7	34 605	24 837	35 837	41 170	31 822	27 021	24 661	22 436	242 389
7	8	24 551	19 950	30 166	35 672	27 199	22 885	20 674	18 057	199 154
8	9	17 783	14 779	21 776	26 353	20 984	19 133	16 452	14 892	152 152
9	10	13 783	12 188	16 802	20 279	16 985	16 055	13 265	12 661	122 018
10	11	10 572	9 233	13 725	16 366	13 716	13 725	11 629	10 728	99 694
11	12	7 544	6 778	10 759	12 446	11 142	11 061	9 147	8 768	77 645
12	13	6 879	7 761	14 567	12 193	10 837	13 171	15 039	8 424	88 871
13	14	5 200	4 638	7 687	9 156	8 531	9 148	7 675	7 218	59 253
14	15	4 950	4 084	6 630	8 393	7 415	8 124	6 589	6 168	52 353
15	16	4 193	3 711	5 941	7 248	6 599	7 249	5 901	5 697	46 539
16	17	3 893	3 679	5 488	7 876	6 427	7 324	5 874	5 089	45 650
17	18	3 082	2 552	4 193	5 232	4 875	5 852	4 617	4 449	34 852
18	19	2 467	2 528	4 202	5 421	4 344	5 276	4 377	4 462	33 077
19	20	2 573	2 495	4 317	5 378	4 350	4 772	4 078	3 966	31 929
20	21	2 233	1 963	4 087	4 405	3 662	4 369	3 794	3 469	27 982
21	22	2 146	1 827	3 457	3 838	3 682	4 189	3 629	3 289	26 057
22	23	1 959	1 645	2 826	3 278	3 307	3 539	3 089	3 108	22 751
23	24	2 089	1 581	2 547	2 964	2 994	3 299	2 749	2 704	20 927
24	25	1 643	1 512	2 316	2 606	2 783	2 997	2 369	2 420	18 646
25	26	1 967	1 877	2 668	3 170	2 935	2 911	2 661	2 432	20 621
26	27	1 671	1 455	2 139	2 481	2 497	2 680	2 038	1 943	16 904
27	28	1 511	1 615	2 147	3 330	2 558	2 830	2 105	1 775	17 871
28	29	1 445	1 770	2 056	4 245	2 708	3 300	2 073	1 801	19 398
29	30	1 609	1 253	1 714	2 766	2 276	2 485	2 009	2 048	16 160
30	31	2 543	1 263	1 609	2 144	1 840	2 066	1 679	1 898	15 042
31	32	2 045	1 033	1 383	1 794	1 615	1 788	1 575	1 592	12 825
32	33	1 094	973	1 860	1 898	1 561	1 820	1 656	1 308	12 170
33	34	1 162	923	1 707	1 611	1 354	1 572	1 674	1 282	11 285
34	35	2 645	1 333	1 620	1 756	1 389	1 400	1 496	1 308	12 947
35	36	1 025	927	1 396	1 371	1 272	1 311	1 304	1 119	9 725
36	37	975	813	1 040	1 271	1 200	1 240	1 016	1 067	8 622
37	38	759	816	1 464	1 405	1 086	1 186	1 242	1 020	8 978
38	39	793	910	1 603	1 531	1 093	1 249	1 221	944	9 344
39	40	1 707	1 142	1 534	1 610	1 172	1 088	1 075	896	10 224
40	41	1 209	1 168	2 992	3 219	1 922	1 154	1 492	872	14 028
41	42	651	634	1 141	1 310	1 165	813	896	704	7 314
42	43	759	520	720	711	718	698	697	649	5 482
43	44	1 111	534	650	990	636	632	649	586	5 788
44	45	747	432	554	6 129	653	586	500	601	10 202
45	46	329	323	439	2 181	531	625	471	534	5 433
46	47	269	346	425	550	520	546	430	579	3 665
47	48	228	323	362	417	460	478	329	457	3 054
48	49	255	294	348	389	468	424	325	540	3 043
49	50	518	326	378	437	509	380	276	458	3 282
50	51	216	272	477	587	497	427	253	372	3 101
51	52	173	227	418	451	431	365	239	394	2 698
52	53	147	238	425	354	428	354	234	316	2 496
53	54	195	260	605	616	417	385	251	313	3 042
54	55	207	376	1 948	1 520	725	701	336	299	6 112
55	56	109	144	275	330	281	249	178	236	1 802
56	57	98	138	217	251	229	191	129	213	1 466
57	58	85	120	177	176	187	150	177	194	1 266
58	59	88	107	150	182	229	182	211	188	1 337
59	60	63	129	875	571	325	400	231	203	2 741
60	61	52	79	250	216	177	192	101	152	1 219
61	62	56	56	114	135	115	117	112	154	860
62	63	59	49	83	107	110	101	91	127	727
63	64	47	49	58	84	93	91	70	127	629
64	65	50	54	72	75	83	87	82	120	623
65	66	38	41	60	92	69	100	74	95	569
66	67	26	32	50	79	62	69	73	99	500
67	68	29	38	59	80	70	65	56	109	506
68	69	28	51	45	65	56	57	63	99	468
69	70	60	47	57	95	83	52	65	93	552
Total		12 491 449	6 891 598	8 954 721	9 445 885	6 146 265	3 909 545	3 922 344	2 621 443	54 383 250

CD Labels (Custom Designed)

Weight Class										
0	0.5	3 200	1 610	3 257	2 277	601	405	674	3 997	16 021
0.5	1	1 502	910	1 609	1 379	783	201	681	3 032	10 097
1	2	4 976	2 704	1 862	1 565	850	195	759	2 563	15 474
2	3	1 637	1 376	2 506	1 362	791	197	830	1 313	10 012
3	4	2 098	1 124	1 614	884	525	238	488	935	7 906
4	5	1 013	590	1 145	638	499	193	411	877	5 366

5	6	580	437	874	466	429	182	531	879	4 378
6	7	707	397	770	420	331	187	377	797	3 986
7	8	561	363	695	332	326	185	232	811	3 505
8	9	418	288	533	357	299	138	141	591	2 765
9	10	474	229	452	358	286	158	154	573	2 684
10	11	331	179	381	338	261	169	145	576	2 380
11	12	316	307	363	373	269	214	155	605	2 602
12	13	175	267	339	352	261	184	174	556	2 308
13	14	216	236	353	382	267	185	145	456	2 240
14	15	141	237	379	402	244	225	173	475	2 296
15	16	238	319	354	423	218	232	189	386	2 359
16	17	169	251	317	458	230	226	209	466	2 326
17	18	167	301	324	486	225	249	210	408	2 370
18	19	181	305	295	483	203	282	189	752	2 690
19	20	159	313	297	438	278	255	199	463	2 402
20	21	167	316	265	497	289	321	231	492	2 578
21	22	157	311	263	480	339	308	177	435	2 470
22	23	138	278	307	553	405	343	183	398	2 605
23	24	175	281	346	637	449	344	209	483	2 924
24	25	172	326	408	613	512	358	203	457	3 049
25	26	135	355	429	644	561	369	205	501	3 199
26	27	145	308	354	673	497	330	250	492	3 049
27	28	161	309	444	683	435	317	248	519	3 116
28	29	148	289	343	635	327	260	253	448	2 703
29	30	137	386	351	656	267	259	301	406	2 763
30	31	156	576	339	616	208	147	262	328	2 632
31	32	107	381	313	590	178	151	281	287	2 288
32	33	119	172	305	502	152	118	282	253	1 903
33	34	117	151	276	527	148	116	258	250	1 843
34	35	119	116	311	472	120	143	214	187	1 682
35	36	104	108	309	428	102	99	194	198	1 542
36	37	109	93	217	407	86	79	176	186	1 353
37	38	217	116	293	337	78	75	156	170	1 442
38	39	107	93	213	298	68	50	136	133	1 098
39	40	116	76	234	305	66	100	101	118	1 116
40	41	130	75	247	184	64	51	102	113	966
41	42	108	62	260	163	58	68	94	137	950
42	43	74	62	196	158	67	67	83	120	837
43	44	60	59	188	167	63	67	91	149	844
44	45	47	51	217	138	58	60	83	134	788
45	46	65	58	212	175	58	48	89	150	856
46	47	36	41	200	134	62	46	85	157	761
47	48	37	45	212	137	44	41	93	183	792
48	49	22	44	177	113	49	40	72	205	722
49	50	29	57	193	134	51	32	113	172	781
50	51	25	55	167	141	67	34	99	150	723
51	52	31	57	162	139	65	39	84	166	743
52	53	15	57	140	122	46	37	128	130	675
53	54	24	41	108	113	51	30	122	134	623
54	55	19	35	122	89	30	25	102	118	540
55	56	10	33	80	68	23	20	95	107	438
56	57	8	20	84	78	28	22	50	100	390
57	58	16	19	58	62	21	18	52	91	347
58	59	14	20	55	43	22	10	50	64	278
59	60	5	22	54	35	19	13	40	72	260
60	61	5	14	38	27	12	9	34	85	224
61	62	7	14	42	18	8	8	18	74	189
62	63	4	7	38	21	6	6	25	81	188
63	64	1	10	46	21	7	5	40	66	196
64	65	3	10	29	14	8	10	50	48	172
65	66	2	2	6	5	3	1	9	42	70
66	67	6	2	4	4	4	1	5	30	54
67	68	2	0	5	2	1	0	10	37	57
68	69	2	1	10	2	2	1	6	27	51
69	70	4	1	5	2	1	1	9	29	52
Total		22 876	18 778	28 389	27 246	14 461	9 597	13 319	31 423	166 089
Grand Totals		12 525 687	6 918 479	8 992 161	9 484 840	6 182 974	3 922 555	3 938 615	2,655,814	54 621 125

Note: RPW volume adjustment factor = 0.9908826
The FY 2004 RPW Volume is 54 123 124 pieces

1 CHAIRMAN OMAS: Is there any additional written
2 cross-examination for witness Taufique?

3 MR. TIDWELL: Yes, Mr. Chairman. The Postal
4 Service has counter-designated two additional interrogatory
5 responses, the response that was designated MMAT21-55
6 redirected from witness Abdirahman we have counter-
7 designated the answer to subpart (a); and witness Taufique's
8 response to ABA-T21-56, redirected from witness Abdirahman
9 we have counter-designated by adding his response to subpart
10 g.

11 I have one other procedural matter. We had
12 neglected earlier to ask the witness if there were any
13 library references associated with his testimony, so I shall
14 and he shall respond.

15 THE WITNESS: There is only one library reference
16 associated with my testimony which is LR-K-115.

17 MR. TIDWELL: We would ask that be incorporated by
18 reference.

19 CHAIRMAN OMAS: Without objection, so ordered.

20 Is there any additional cross-examination for
21 witness Taufique?

22 (No response.)

23 CHAIRMAN OMAS: There being none, this brings us
24 to oral cross-examination. Three parties have requested
25 oral cross-examination: American Bankers Association and

1 National Association of Presort Mailers, Major Mailers
2 Association, Valpak Direct Marketing Systems Incorporated
3 and Valpak Dealers Association Incorporated.

4 Mr. Hart, would you begin, please? American
5 Bankers Association and National Association of Presort
6 Mailers.

7 MR. HART: Thank you, Mr. Chairman.

8 CROSS-EXAMINATION

9 BY MR. HART:

10 Q Good afternoon, Mr. Taufique.

11 A Good afternoon, sir. How are you?

12 Q Good. Thank you. Could you please turn to your
13 response to ABA&NAPM-T28-3 which was filed in a revised
14 fashion June 27? Let me know when you have it in front of
15 you. There's a question and then there's a table. There's
16 four tables that follow the question.

17 A Yes. T28-3?

18 Q Yes.

19 A Okay. We're there.

20 MR. TIDWELL: Mr. Chairman, I don't know if you
21 all have on your laptop there that interrogatory. I have
22 copies. It's not to introduce it into evidence, it's just a
23 copy of the interrogatory, but I thought it might be helpful
24 with this question if you had a copy of the table.

25 CHAIRMAN OMAS: If you could distribute it,

1 please?

2 MR. TIDWELL: Yes, I will.

3 THE WITNESS: Could I get a copy also?

4 MR. TIDWELL: Again, this is already designated in
5 the record it's just for your convenience.

6 BY MR. TIDWELL:

7 Q I'm going to ask you some questions about the
8 first two tables just to get a couple of clarifications that
9 were attached to the question and then your response.

10 A Sure. Could I get a copy of the table also? I do
11 not have a copy of the table.

12 Q The first of those four tables that are attached
13 to that Interrogatory No. 3 was just copied from the
14 question that was presented by the Commission in the
15 Responding Officer's Information Request 6, Question No. 7.

16 The second table, No. 1, from ABA&NAPM contains an
17 amendment that was made by ABA&NAPM to that hypothetical.

18 My first question to you is -- and take your time
19 to look at the two tables -- will you accept subject to
20 checking that the only change in that Table 1 from ABA&NAPM
21 in the first two columns which are USPS Worksharing Costs
22 and Postage Rates is that the USPS worksharing costs for
23 Category E, we changed it from 13 to 15? You can see it in
24 the box there.

25 A Looking at the table, the change that you made was

1 for Category B. The worksharing costs have been changed
2 from 13 to 15. That is accurate.

3 Q Correct. We didn't make any changes under USPS
4 Worksharing Costs or Postage Rates to either Category A or
5 Category C?

6 A Those are the only changes.

7 Q Thank you. Will you then confirm that with that
8 one change that we made that the incremental pass-throughs
9 for rate categories B and C which had been 71 percent and
10 100 percent, respectively, in the POIR6, Question No. 7,
11 Table 1, that they changed to 100 percent and 100 percent,
12 respectively, in the ABA&NAPM Table 1?

13 A The calculated pass-throughs, which are basically
14 the discount over cost of avoidance or 71 percent in the
15 table that was provided by the Commission in POIR6 Question
16 No. 7, the calculated pass through for the same base
17 Category B which is again discount divided by cost of
18 avoidance is 100 percent.

19 The same holds true for Category C. The pass-
20 through for that Category C is again the discount which was
21 three divided by the cost of avoidance which was one is 300
22 percent. In the case of ABA&NAPM table, the discount is
23 three and the cost of avoidance is three. To the pass-
24 through is 100 percent.

25 Q Thank you. Can you confirm that in the example

1 that I just gave you that as a result of that one change
2 that was made to the ABA&NAPM Table 1 that this change in
3 the pass-throughs from 71 percent and 100 percent in the
4 table at the top is changed to 100 percent and 100 percent?
5 I'm sorry.

6 A You mean 71 percent and 300 percent in the first
7 table.

8 Q Correct. Strike that. Let me rephrase the
9 question. Can you confirm in the example that I just gave
10 you that the adjustment made to Table 1 by the ABA&NAPM
11 table, with this change in pass-throughs that resulted in
12 that ABA&NAPM table is due totally to the change that we
13 made to Category B and not due in any way to any change that
14 was made to Category C?

15 A That is accurate.

16 Q Lastly, can you confirm that under that example
17 that we gave you in ABA&NAPM Table 1 which has the 100
18 percent incremental pass-throughs for Category B and C that
19 the resulting discount for Category C does not exceed the
20 cost avoided for that category?

21 A I believe that was my response to POIR also, that
22 when we do increment and pass-throughs the pass-through for
23 a given rate category that will only be affected by what the
24 pass-through was for the previous level. They are
25 equivalent if you do 100 percent pass-throughs at each

1 level, but they become unequal or they affect the pass-
2 throughs of the other eight categories that follow, but that
3 is true.

4 Q So that in the ABA&NAPM example where we looked at
5 the POIR fixed table and there was a "problem" with Category
6 C where we had 300 percent pass-through, that "problem" --
7 those are my words, not yours -- was removed by adjusting
8 the USPS worksharing costs for Category B?

9 A That is true with one basic note that in this
10 particular case you did not use the cost study to come up
11 with the pass-through for the rates. Basically, the rates
12 were devised by the application of 5.4 percent target
13 increase to all the rates in all rate categories. So we did
14 not have pass-throughs in the traditional sense that you
15 would do in an omnibus rate case that is filed with all the
16 rate design that accompanies it.

17 Q Understood. Could you then turn to your response
18 to ABA&NAPM/USPS T28-21 and in particular, your response to
19 subparagraph 4.7. Just let me know when you have that in
20 front of you.

21 MR. TIEWELL: Counsel, was that T28, 20 or T21?

22 MR. HART: No. I'm sorry. 20(a).

23 THE WITNESS: It's T21-20.

24 MR. HART: I apologize. It was T21-20(a).

25 MR. TIEWELL: Thank you.

1 MR. HART: Thank you.

2 BY MR. HART:

3 Q Now, we've just talking about incremental pass-
4 throughs because we've been talking about the ABA&NAPM
5 Interrogatory No. 3 and the POIR6 Question No. 7, but can
6 you confirm for us that it is the Postal Service's practice
7 and in your belief past Commission practice to use both
8 metered mail as the benchmark to determine worksharing cost
9 savings for all first-class letter mail automated rate
10 categories?

11 A Long question. Could you repeat it one more time,
12 please?

13 Q Yes. Can you confirm that it is the Postal
14 Service's practice and in your opinion has been the past
15 Commission practice to use both metered mail as the
16 benchmark to determine workshare cost savings for all first-
17 class letter mail automated rate categories?

18 A It is my understanding that the Postal Service and
19 the Commission has used the BMM or buckwheat and bailers
20 benchmark for the automation rate categories.

21 MR. HART: That's all I have. Thank you.

22 CHAIRMAN OMAS: Thank you, Mr. Hart.

23 Mr. Morgan?

24 MR. MORGAN: Thank you, Mr. Chairman,
25 Commissioner. Good afternoon.

1 CHAIRMAN OMAS: Good afternoon.

2 MR. MORGAN: Valpak has three interrogatories to
3 witness Taufique that we understand have been redirected to
4 witness Abdirahman and we may want to designate those when
5 those are answered at that time.

6 CHAIRMAN OMAS: Without objection.

7 CROSS-EXAMINATION

8 BY MR. MORGAN:

9 Q Mr. Taufique, first I have a couple of questions
10 regarding how you arrived at the nonprofit ECR rates that
11 are being requested by the Postal Service.

12 CHAIRMAN OMAS: Excuse me, Mr. Morgan. Would you
13 bring the mic closer to you so that we can hear you?
14 Unfortunately, these are not the modern mics. We will have
15 better mics at the new place. You have to talk directly
16 into these.

17 MR. MORGAN: Okay.

18 CHAIRMAN OMAS: Thank you.

19 MR. MORGAN: You're welcome.

20 BY MR. MORGAN:

21 Q As I understand it, according to Public Law No.
22 106384 nonprofit rates are to be set so that the average
23 revenue per piece is as nearly as practicable to 60 percent
24 of the average revenue per piece of the corresponding
25 commercial rate and that those revenue per piece

1 calculations are to be made using TYBR billing
2 determinations.

3 Let's take each of those parts one at a time.
4 First of all, the law provides that you're supposed to
5 calculate the average revenue per piece with TYBR billing
6 determining. You didn't initially use TYBR billing
7 determinations. Is that correct?

8 A That is accurate as far as to the response that
9 are provided to under the numbers, but we corrected that and
10 revised the numbers based on TYBR billing determinants and
11 the proposed rates.

12 Q Thank you. I know there was a similar problem in
13 11-11. Are you aware of that?

14 A I've seen the issue that was discussed and the
15 government's decision.

16 Q Then that was obviously an incorrect application
17 of the statute using TYAR billing --

18 A Fortunately, in this case the reserve for amounts
19 that differed will be applied because of the fact that this
20 was an across the board increase. There won't be much of a
21 change in the billing determinant from TYBR to TYAR, so the
22 resulting ratio of revenue per piece was not that
23 significantly different from what we had before.

24 Q Second, let's discuss the term as nearly as
25 practicable.

1 A Okay.

2 Q Let's start generally. How would you define those
3 words?

4 A The application of this particular statute in the
5 context of rate making basically is in the context of the
6 rate case that we are working on. I don't know how much
7 rate making work are you familiar with, but basically when
8 you do rate making you're expected to cover a lot of things
9 and nothing falls in perfectly, you know?

10 You follow one part of the theory in rate making
11 and it doesn't work all the time. There are reasons why you
12 want to deviate from one thing or the other based on the
13 context of that part of the rate case, whether it be pass-
14 throughs or other applications.

15 The interpretation that Postal Service had in this
16 case of as nearly as practicable, my understanding is that
17 what we proposed were legal rates under the statute. That
18 is our understanding of the law. We can disagree on the
19 understanding of the law, but that is our understanding of
20 the law.

21 We thought that the significant increase for the
22 nonprofit ECR matters was not warranted in this case. As
23 much possible our goal was to apply the 5.4 percent
24 increase. We did not think the nonprofit ECR matters should
25 pay a significantly higher rate or percent change compared

1 to all the other classes paid.

2 Where we did not have choice we made the
3 exception, but over here we thought the law allowed us to
4 propose 5.4 percent application for nonprofit ECR and these
5 would be legal rates. That's our understanding of the law.
6 I'm not an attorney of advice that this is a correct
7 application of the law.

8 Q I understand. So you would say that the term as
9 nearly as *practicable* doesn't necessarily mean rounding, you
10 take into consideration other factors as well?

11 A In the context of this rate case we take -- the
12 target was 5.4 percent I believe across the board to all
13 rate categories. We believe that this proposal meets the
14 requirement of the statute. In a different rate case, in a
15 different context with other design changes the reserve
16 could be different.

17 We would be much closer to 60 percent than what we
18 are over here, it's possible. We have done that I think in
19 the past.

20 Q Well, let's assume for a moment that this phrase
21 as nearly as *practicable* applied to a first-class mail rate
22 category. Let's think in terms of applying that to a first-
23 class mail where the rates are expressed in whole integers.
24 Would the meaning of that term mean that rates could be
25 rounded up or down to the nearest cent and that would be

1 okay?

2 A The rounding conventions are quite different for
3 different classes of mail. In the first-class, single piece
4 we actually round it up or down to a whole cent. In
5 automation categories it cent for cent. In some categories
6 of special services that I've learned just recently there is
7 five cents.

8 Q So the rounding conventions are quite different
9 for classes of mail and we apply those rounding conventions
10 and have done that in this case also. Some of the resulting
11 percent changes deviate from 5.4 because of the rounding up
12 and down in some cases, so yes. There is no law that
13 requires us to round one way or the other.

14 Q No, no, no. I'll say a first-class mail context and
15 say there is a particular rate that requires you to be as
16 neatly as practicable to a certain criterion, would you
17 consider that in the first-class context to just mean by
18 rounding or would you use other factors, like you've done
19 with the ESFT?

20 A Again, like I said, the context of that particular
21 case, the issues, because cost numbers change over time, the
22 costs of higher and lower are beyond our expectations in
23 some cases, the cost estimate for worksharing change over
24 time, so in the context of a particular case that could
25 change.

1 I'm not following your question. I'm not trying
2 to understand. We do rounding on a regular basis.

3 Q Well, I'm mainly trying to focus on the words as
4 *nearly as practicable* and see how you have used that. Are
5 you aware of any other instances in the PRA that use the
6 term *as nearly as practicable*?

7 A I'm not familiar with any places where this would
8 be used.

9 Q I think one place that it's used is in nonprofit
10 periodicals and classroom periodicals. There's a five
11 percent I guess discount that says *as nearly as practicable*
12 to five percent. Have you seen that before?

13 A I'm sure I've seen the law because I worked with
14 periodicals for a long time. I just don't remember seeing
15 *as nearly as practicable* in that context.

16 Q So in your experience at the Postal Service or
17 anywhere else can you identify any instance where the term
18 has been used to justify a rate which varied from a mandated
19 level more than rounding to the closest 10 percent?

20 A The application of five percent to nonprofit and
21 classroom, I've done that in the past and there were no
22 issues that I recall in that area. In this particular case,
23 this was not an issue that was taken lightly. There was a
24 discussion within the Postal Service about this. A number
25 of people talked about it.

1 Our interpretation was that in the context of this'
2 rate case it was the rates were legal under the statute.

3 Q They were *as nearly as practicable*?

4 A As nearly as practicable in this case and in the
5 next case in the context of a traditional omnibus case
6 things may change and we may be closer to 50 percent than
7 where we are at this point in time. Like I said, the impact
8 on the mailers -- especially the nonprofit ECR mailers --
9 the rate increase would have been significantly high than
10 what we had proposed in our proposal.

11 Q You say they may be closer in another case. Could
12 they be farther away?

13 A Again, the context of that case would determine
14 that. I cannot forecast as to what will happen in the next
15 rate case or the rate case after that.

16 Q Well, I guess how far would you consider it if you
17 could go from 60 percent and still be considered as nearly
18 as practicable?

19 A I don't have a number, but in the context of that
20 particular rate case, again, we will get the advice of our
21 attorneys, and discuss it and determine whether this was a
22 feasible application of the law or not.

23 Q Now, look specifically at your testimony. Could
24 you turn to page 11, particularly lines 17 through 21? Do
25 you have those there?

1 A Yes.

2 Q Am I right in saying that the rates you proposed
3 for standard commercial ECR yield an average increase of 5.6
4 percent?

5 A I defer to my colleague who testified earlier in
6 terms of calculation of percent changes. My error that I
7 did not allow, did not heed the constant in calculating the
8 percent changes, so Ms. Robinson's calculations are closer
9 to reality than mine are.

10 Q For standard nonprofit ECR, in your testimony you
11 said it was 5.9 percent. I don't know if the other
12 witness --

13 A I believe Ms. Robinson's numbers were lower than
14 mine. 5.6 percent, I believe. That is based on the
15 conversation that Mr. Olson had with her this morning.

16 Q Also, here you say that the average revenue per
17 person for nonprofit ECR is 56 percent of the average revenue
18 per person for commercial ECR. Does that still apply?

19 A That still applies. The percent change basically
20 is when the volume mix changes you can have the percent
21 change that is different and if you keep the volume as
22 constant the numbers would not change. The proposed rates
23 do not change here.

24 Q It's not 60 percent, right, it's 56?

25 A Even after the application of TYBR, but in

1 determinants it is still 56 percent.

2 Q Now, refer to the next page, lines 10 through 12.
3 You say that nonprofit ECR rates would have to increase on
4 the order of 13 percent for its average revenue per piece to
5 reach 60 percent of commercial ECR average revenue per
6 piece.

7 A That is an estimate on our part that they would
8 have to go up this much for this ratio to be 60 percent.

9 Q So you tempered the rate increase for nonprofit
10 ECR rates reducing it from 13 percent to I guess 5.6
11 percent?

12 A I totally disagree with the characterization that
13 we tempered with the rate increase for nonprofit ECR. Our
14 mandate was to apply 5.4 percent across the board as much as
15 possible except where we thought the law did not allow us.

16 When the cost was not being covered or when we
17 thought half the mark-up requirement was not being met we
18 applied 5.4 percent to all rate classes or all subclasses,
19 and the resulting ratio of revenue per piece between
20 nonprofit ECR and commercial ECR was 56 percent.

21 Again, like I said, it was our determination that
22 the law allows us to propose these rates and they would be
23 legal under the statute.

24 Q Can you now look at your response to Valpak 228,
25 2 b ?

1 A Yes.

2 Q We asked you about your justification for reducing
3 the percentage increase for nonprofiting. Is that right?

4 A Yes.

5 Q At the end of your response there you said the
6 policy reasons stated in witness Potter's testimony -- USPS-
7 T1 -- were the basis for the Postal Service's judgment that
8 a higher rate increase for standard mail and ECR was not
9 practicable in this case. Is that correct?

10 A Yes. That's true.

11 Q Yesterday, Mr. Olson of our office as General
12 Potter if he directed you to apply this statute PL -- Public
13 Law 1963 -- before as you did. I believe that the
14 transcript will show that he said that he did not
15 specifically direct that. Would you agree with that
16 statement?

17 A Mr. Potter added that the staff economists
18 I think he used the word staff economist, I do not recall
19 exactly I don't have a transcript in front of me, but he
20 said following the general guideline that was given to the
21 pricing witness, to the pricing department actually to apply
22 the 5.4 percent of it.

23 It was not a specific directive. Trust me Mr.
24 Potter never calls me about these things. This was a
25 general directive to all of us to increase these rates by

1 5.4 percent and we thought that applying 5.4 percent to
2 nonprofit ECR in this case it was the application of the
3 general guideline that was given to us.

4 I don't think he directed none of my colleagues on
5 the subject. There was a general direction, though for the
6 board of governors that you could find an adjustable rate
7 increase of 5.4 percent and we were all following that
8 particular directive.

9 Q Did you make the decision to set the nonprofit ECR
10 rates at what you did based on the language as nearly as
11 practicable? That was one of the factors, I'm sure.

12 A We applied 5.4 percent to nonprofit ECR. We
13 started out and all of the rates basically were increased
14 5.4. That was our goal. For the purpose of heeding legal
15 requirement of the statute we looked at the numbers, the
16 ratio of revenue per piece and like I said, our
17 interpretation of the law, the Postal Service's
18 understanding of the law is that these rates that we
19 proposed are legal under the statute.

20 Q So what were the other reasons for deciding not to
21 make it more closely to 60 percent?

22 A Like I said, the overriding reason was that 5.4
23 percent was the directive and we're following that. When we
24 looked at the ratio we knew the ratio was not 60 percent, it
25 was off. Then again, there was a discussion on the subject

1 and the advice that we got was that the proposal that we had
2 was legal.

3 That was our concern. As long as the 5.4 percent
4 was fair and equitable only we showed that we're not
5 exceeding the limit of the law in any place where we were,
6 we made the exceptions in some cases.

7 Q So as nearly as practicable is really the only
8 reason you didn't get closer to 60 percent?

9 A This was fair and equitable application of 5.4
10 percent across the board. If we had done 13 percent, that
11 would not have been fair. We thought this was legal, then
12 it was fair to apply 5.4 percent to nonprofit ECR also.

13 Q Do you have an opinion as to whether the statute
14 has priority over a particular Postal Service policy if
15 there's a conflict between the two?

16 A I don't have an opinion. I'm not a lawyer.

17 Q So you wouldn't know whether a correctional
18 statute has

19 A I think what we would do is we would follow the
20 law in all instances basically. Postal policy is derived
21 from the law. Pricing witnesses quote the pricing criteria
22 in their testimony. That is our major concern. I mean,
23 basically you know the policy that we make and the rates
24 that we propose are legal.

25 Q If there was a conflict which one would you go

1 with?

2 A Whatever my lawyer tells me.

3 Q Finally, on this topic would you agree with me
4 that if the Commission were to temper the 5.6 percent
5 average rate increase for commercial ECR that this would
6 permit the Commission to also temper the increase for
7 nonprofit ECR below 13 percent and still meet the 60 percent
8 standard set out in Public Law 106384?

9 A One more time, please?

10 Q If the Commission were to temper the commercial
11 ECR rates below what are currently requested could they then
12 reduce the nonprofit ECR rates to 13 percent and then comply
13 with the 60 percent requirement in Public Law 106384?

14 A I think we've answered that. You had
15 interrogatory on the subject, I do not know exactly which
16 one, but

17 Q Well, we asked if you had left the nonprofit ECR
18 rate as requested what would happen to the --

19 A There are a number of issues in any rate picking
20 exercise meeting the revenue requirement. A rate level
21 witness in a traditional rate case and in this rate case we
22 knew exactly how much revenue we needed and what 5.4 would
23 reduce.

24 If we had reduced the percent change for any
25 larger class much below 5.4 percent we would not have met

1 the revenue requirement that we wanted to meet the revenues
2 that we wanted of the test year.

3 There are a number of issues that go into
4 proposing rates and we want to be sure that rates that we
5 propose are legal, meet the requirements of the law, but
6 there a number of issues where we need to flexibility to do
7 things differently.

8 The Commission and Postal Service had used the
9 flexibility within the law to apply the law and to come up
10 with rates that are legal and that meet the revenue
11 requirements for the past year. Does that answer your
12 question? I'm not sure exactly what your question was.

13 Q I'm not sure, either. Well, now I have some
14 questions about the relationship between standard regular
15 and standard ECR mail. Could you please refer to your
16 response to Valpak T28-2?

17 A Any specific subpart?

18 Q Specifically, Part A right now. You can see it
19 focuses on two categories of standard mail, all letters.
20 One is five digit, prebarcoded and the other is basic ECR.
21 Do you see those two --

22 A Yes.

23 Q We're talking about letters only. Part A
24 basically says what if the basic ECR letter rate is lower
25 than the five digit prebarcoded rate? Do you think the five

1 digit prebarcoded mail would move to basic ECR? Now, look
2 at your answer to Part A.

3 At the end of your response you say if a mailer of
4 five digit automation letter has the density to qualify for
5 ECR which is likely then the mailer could qualify for ECR
6 prices.

7 A Uh-huh.

8 Q Can you explain why you believe it to be likely
9 that a mailer of five digit automation letters will have the
10 density to qualify for ECR?

11 A The goal in this whole exercise is to make sure
12 that the automation mail does not move to nonautomation
13 categories. That's the goal.

14 If the incentive is there for the mailers to
15 forsake the automation category and move it to the
16 nonautomation category then that would defeat our automation
17 goals in terms of getting the letters that are delivery
18 point sequenced in the plant and some of them -- they become
19 part of one big mail stream rather than being a separate
20 mail stream, and a basic ECR, they go to that delivery unit.

21 I'm not an official, but that was the goal. It is
22 likely that if a five digit mailer has enough density, if
23 the rate is significantly cheaper for basic ECR it's
24 possible that if there's a density they would move to that
25 particular category of mail.

1 Q What is the basis for your belief that they'd have
2 the density?

3 A I don't know the exact numbers, but the
4 requirement for a five digit tray and a basic ECR is not a
5 whole lot different, at least my recollection of that. It's
6 possible that if a rate incentive was there, if it was a few
7 added pieces they can move to basic ECR which is a
8 nonautomation category.

9 We would prefer to keep the mail in the automation
10 category.

11 Q Is there any evidence on the record for that
12 belief that they're likely to do that to qualify? You said
13 you didn't have the numbers, but you believe that they would
14 be likely to qualify because of their density?

15 A Right.

16 Q There's no evidence on the record, right, to
17 support that belief?

18 A I believe that is accurate.

19 Q Can you tell me whether those pieces that could
20 ship to ECR are in the regular subclass because they moved
21 there from ECR in the last few years because the five digit
22 automation rate is lower?

23 A Movement of mail from basic ECR to five digit
24 automation?

25 Q Yes.

1 A I have not looked at the history of standard mail
2 and ECR in detail, but it is my understanding that some
3 mailers move from basic ECR, there has been some shift.

4 Q There has been some shift.

5 A Shift from five digit automation, and we would
6 like to keep it there.

7 Q Another part of the question in Part A asks you to
8 explain the ways in which a mailer of barcoded five digit
9 letters might succeed in qualifying for the ECR base rate.
10 Is your answer to this part of the question simply that if
11 they have the density, they could do so easily?

12 A What subpart was that?

13 Q It's the last part of A.

14 A Part A. Right. I think one of the primary
15 factors would be density for the mailer to move from five
16 digit automation to basic ECR given the rate incentives are
17 there and if they have the density they would move there.

18 Q Are there any other significant factors other than
19 density?

20 A The price.

21 Q Well, the price, but suppose they don't have the
22 density. Is it still easy to go to ECR?

23 A If there's a matter of the density they would not
24 move to ECR.

25 Q So it's never possible to qualify for ECR without

1 having the required density? If you don't have the density,
2 you don't have ECR. Okay.

3 A The difference between five digit automation
4 category and ECR because you're preparing mail for five
5 digit you have close to that density level for ECR.

6 Q So just based on density you think it's likely
7 that the standards for five digit automation could qualify
8 it for ECR?

9 A If there are price incentives for the mailers to
10 move, have the density, they would want to move to a cheaper
11 rate category.

12 Q Is it likely to do so because they have the
13 density to do so?

14 A If they have the density and the rate is cheaper
15 they would want to qualify for a cheaper rate.

16 Q Now, look at the first part of your answer to Part
17 A there. You say it is preferable and in parentheses from a
18 mail processing point of view to have those pieces in five
19 digit instead of basic ECR. Are there any other rate
20 setting criteria or is the mail processing pretty much about
21 it?

22 A One of the goals of rate design is to reflect the
23 operating environment of the Postal Service. I think
24 they've defined a change over time. Because of the change
25 it changes the operating environment of the Postal Service.

1 If Postal Service would like to keep the mail in the
2 automation mail stream then it is our job to propose rates
3 that would cause it to happen.

4 That will benefit that particular mail class as
5 well as all of the other mail classes because the cost of
6 processing that mail would be lower than it would be
7 otherwise.

8 Q So mail preparation is pretty much the only factor
9 for that than. Is that correct?

10 A Mail processing is an important factor for us. We
11 do a lot of things to make sure that mail moves into
12 automation mail stream.

13 We provide incentives and discounts to mailers to
14 prepare the mail in such a fashion that they become
15 automation compatible and the mail goes through our system
16 with relative ease compared to manual handling or compared
17 to more extensive ways of handling that mail.

18 Q So for this particular difference is mail
19 processing the only factor?

20 A Generally speaking, the policy of the Postal
21 Service will be to keep the mail in the automation mail
22 stream --

23 Q So yes?

24 A -- as much as possible. As much as possible.

25 That is because any of the various rate subclasses you would

1 find there are incentives and discounts for preparing the
2 mail in a fashion that would allow the mail to be processed
3 by our machines.

4 Q So you'd say yes, mail processing is the only
5 reason for the difference?

6 A Is the overall efficiency of processing the mail.
7 Yes. And delivering the mail, actually. Not just mail
8 processing, but delivery would be more efficient also as a
9 result of the mail being in this mail stream.

10 Q On subpart (b) here to Question 20 it says is
11 there concern that standard barcoded five digit letters
12 might leave the standard barcoded five digit category and
13 move to the ECR subclass? Please explain why the logical
14 place to move would not be the barcoded ECR basic category
15 instead of the ECR category?

16 A In your response you say the automation rate
17 necessary in ECR is of limited availability, so it is not a
18 logical place to which five digit letters would move. What
19 are the limitations? What makes it of limited availability?

20 A Carrier route mailing which is automation
21 compatible is accepted only in a few places around the
22 country. I don't know what the percent is, but I think it's
23 about 30 percent of the facilities would accept the carrier
24 route automation mail. Either they do it manually or they
25 process the mail at the delivery unit.

1 There aren't too many of those delivery units that
2 have the capability or the automation to process that mail.
3 Generally speaking, the five digit automation mail would end
4 up in a plant where it would be processed with all the other
5 letter mail and it would be delivery point sequenced over
6 there.

7 So the carrier route automation category is sort
8 of a dying breed in some ways, actually.

9 Q So they have to be destined for DDUs that have DSB
10 --

11 A I was looking for the same name.

12 Q It's like it's a three pass?

13 A Right. Exactly.

14 Q So that's pretty much the limitation --

15 A Exactly. That's a huge limitation, in fact.

16 MR. MORGAN: Well, thank you, Mr. Taufique.

17 No further questions.

18 CHAIRMAN OMAS: Thank you, Mr. Morgan.

19 Any other party who wishes to cross-examine Mr.
20 Taufique?

21 (No response.)

22 CHAIRMAN OMAS: There being none are there any
23 questions from the bench?

24 (No response.)

25 CHAIRMAN OMAS: Seems to be none.

1 Mr. Tidwell, would you like some time with your
2 witness?

3 MR. TIDWELL: Yes, Mr. Chairman.

4 CHAIRMAN OMAS: Redirect?

5 MR. TIDWELL: Five minutes.

6 CHAIRMAN OMAS: Why don't we take about a five
7 minute break. We'll be back at 2:20.

8 (Whereupon, a short recess was taken.)

9 CHAIRMAN OMAS: Before we proceed with redirect I
10 have two more responses to POIR that I want to add to the
11 record today. They are POIR7, Questions 14 and 16.

12 Witness Taufique, if those questions were asked of
13 you today would your answers be the same as those you had
14 previously provided in writing?

15 THE WITNESS: Yes.

16 CHAIRMAN OMAS: With that, I'm handing the
17 responses to Mr. Tidwell and your answers to those questions
18 to the reporter and direct that they be admitted into
19 evidence and transcribed.

20 The documents referred to
21 were marked for identification
22 as Exhibit Nos. POIR7,
23 Questions 14 and 16 and were
24 received in evidence.)

25 //

RESPONSE OF WITNESS TAUFIQUE
TO POIR NO. 7, QUESTION 14

14. Please refer to LR-K-115, USPST28Cs spreadsheets, sheet SS30 Return Receipts. The "Electronic" volume projections are all listed as zero. Endnote number three on this page explains, "Electronic return receipt volume for 2004 is not available because of the delayed implementation of the product. No volume projections have been made to the test year."

- (a) Please describe the implementation status of this service.
- (b) Since completing this study, has Electronic Return Receipt volume for 2004 been made available? If so, please provide the information.

RESPONSE:

- a) The electronic option for return receipt service was implemented on September 9, 2004.
- b) No volume data for the electronic option were collected for FY 2004. Some FY 2005 data will be provided in response to Question 16 of POIR No. 8.

RESPONSE OF WITNESS TAUFIQUE
TO POIR NO. 7, QUESTION 16

16. Please refer to LR-K-115, USPST28Cs spreadsheets. In sheet "SS-37 Zip Coding," the AC #43381 "FY 2004 Revenue" is listed as \$322,462, whereas in sheet "SS-13 Correction of Mail. Lists", the AC #43381 "FY 2004 Revenue" is listed as \$107,756. Please reconcile these figures.

RESPONSE:

The \$107,756 revenue should have been used in the revenue calculation in the ZIP Coding of Mailing Lists workpaper. Therefore, the calculated TYBR revenue for this service (using 7.2 percent of the correct total revenue of \$107,756) should be \$7,758 and the TYAR revenue should be \$8,146.

1 CHAIRMAN OMAS: Now, Mr. Tidwell, do you wish to
2 redirect?

3 MR. TIDWELL: No, Mr. Chairman. I just wish to
4 make an observation. That I think we can all be gratified
5 that Mr. Morgan wrestled the microphone away from Mr. Olson.

6 CHAIRMAN OMAS: Would you repeat that again?

7 MR. TIDWELL: I think we should all be grateful
8 that Mr. Morgan wrestled the microphone away from Mr. Olson.
9 Mr. Olson had indicated heavy cross for witness Taufique and
10 based on his morning session it looked like we were heading
11 for six to eight hours, but we should all be grateful that
12 he deferred to a colleague with better time management
13 skills.

14 CHAIRMAN OMAS: Thank you, Mr. Tidwell. Thank
15 you, Mr. Olson. Thank you, Mr. Morgan.

16 Mr. Taufique, that completes your testimony here
17 today and we appreciate your appearance and your
18 contribution to our record. You are now excused.

19 Witness excused.

20 CHAIRMAN OMAS: This concludes today's hearing.
21 We will reconvene on Wednesday morning -- tomorrow -- at
22 9:30 a.m. when we will receive testimony on the Postal
23 Service witness' Hatcher, Cutting, Mayes and Abdirahman.
24 Those are the witnesses who will be appearing before us
25 tomorrow.

1 Thank you very much. These hearings are
2 concluded.

3 (Whereupon, at 2:23 p.m., the hearing in the
4 above-entitled matter was recessed, to reconvene on
5 Wednesday, June 29, 2005, at 9:30 a.m.)

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REPORTER'S CERTIFICATE

DOCKET NO.: R2005-1

DOCKET NO.: R2005-1
CASE TITLE: Request of the United States Postal Service for a
unannounced decision on Charges in Rates of Postage and Fees
for Postal Services
HEARING DATE: 6/28/05

HEARING DATE: 6/28/05

LOCATION: Washington, D C

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Rate Commission.

Date: 6/28/05

[Signature]
Official Reporter

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